Virtual Accounts: innovation to help banks exceed customer expectations
Table of contents

03 - 04  Introduction
05 - 07  The key drivers for change
08 - 11  Can virtual accounts be part of the solution?
12 - 15  Selected virtual account management propositions
16 - 18  Choosing the right partner to implement virtual accounts
19 - 20  Summary
21 - 23  About the research
Introduction
Introduction

Corporates are under increasing pressure to be more efficient and their expectations of their banks are changing as a result. Banks need to be innovative to meet client expectations. Virtual accounts can be part of the solution for banks in meeting the needs of their corporate clients, as well as addressing their own internal strategic challenges, such as increasing regulation and the downward pressure on fee revenue.

In this Tieto whitepaper we present the case for virtual accounts as something that all banks, looking to compete strongly in the areas of payments, cash management and transaction banking, should seriously evaluate.
The key drivers for change
The key drivers for change

Client expectations

Cash has moved from being seen as an asset to a strategic resource. This has brought with it an increasing requirement for better and faster insights into current cash positions. The engagement between treasury and management is now closer, with the corporate treasury function acting as a strategy partner to management decision-making.

Corporate treasurers need to improve efficiencies as they are always expected to do more with less – less budget, less resource and so on. They may also wish to own and administer their account hierarchies without always being dependent on support from their banks. Automation of accounting, reconciliation and cash management processes as far as possible is the goal. To achieve this, self-service, integration and standardisation are key components. For many corporates virtual accounts will be a key component to achieve the efficiencies needed.

Key Drivers

What are virtual accounts?

Virtual accounts are a series of off balance transaction accounts which can be incorporated into various forms of hierarchical structures. A group shadow account in the top of the virtual account structure is linked to and mirrors the physical accounts per currency. Such hierarchies can be used to manage working capital and liquidity processes. Virtual accounts are usually implemented with a strong self-service element, allowing end-users to open, close and structure often complex virtual account hierarchies in line with their needs.
The key drivers for change

Bank challenges and industry transformation

Banks are having to meet customer expectations in a challenging environment. They have to contend with the competitive threat of disruptive new entrants, new technology, increasing regulation and legacy infrastructure. Regulation is driving the need for smart, innovative solutions, yet 80 percent of bank IT budgets on average are tied up with legacy system changes, which make no obvious contribution towards customer value. The amount of regulation in the banking and payments industries seems to be increasing, rather than decreasing. The PSD2, EU general data protection regulation (GDPR), open banking and API provisions, Basel III and know your customer requirements to name but a few. Regulation affects all players in the market, but may impact individual organisations differently, depending on their approach and readiness.

New challengers are eroding bank profits with niche propositions for lucrative areas such as cross-border transfers. For example, UK money transfer company TransferWise and Facebook are usurping banks by allowing customers to send money overseas without leaving Facebook’s Messenger app. Technologies such as mobile and Blockchain will also change the playing field in ways that we can only speculate about. Against this backdrop, banks must implement solutions that support corporate needs quickly and efficiently, without requiring disruptive change to legacy infrastructure. Banks must anticipate and future-proof their activities, rather than wait to be regulated on someone else’s terms and timelines.
Can virtual accounts be part of the solution?
Can virtual accounts be part of the solution?

Introduction to virtual accounts

Virtual accounts are a set of off-balance transaction accounts linked to a physical account and incorporated into various forms of hierarchical structures enabling aggregation and segregation of transactional data. They can be used to manage working capital and liquidity processes. Virtual accounts are usually implemented with a strong self-service element, allowing end-users to open, close and structure often complex virtual account hierarchies in line with their needs.

Payments and collections can be executed on-behalf of in a virtual accounts set up, i.e. POBO and COBO services. With the movements of funds taking place through a single main account, corporates could in theory run their treasury operation with one physical bank account per currency. This allows them to rationalise the number of physical accounts they have, plus reduces account fees and set-up charges.

VAM can be used to set up virtual accounts on payer level (or even invoice level), enabling a fully automated reconciliation process, with enhanced reporting to ERP solutions. With this approach the payer will have a unique account to credit, as the account information cannot be lost in the clearing cycle, the account number information can be used for reconciliation process thus improving the reconciliation ratio. This will save money, both in terms of work effort and improved forecasting.

Virtual Account Management - Client needs
Can virtual accounts be part of the solution?

Benefits to banks

Increase revenue
• Retain existing customers and attract new ones
• Differentiate brand and offering
• Develop new chargeable information services

Cut costs
• Reduce customer attrition
• Cut staff time spent on account set-up and administration

Improve business
• Develop a viable alternative to notional pooling
• Establish a platform to segment the offer and extend the line/reach
• Future-proof your business

Corporates are looking to their banks for products to help them optimise their working capital and short-term funding and liquidity needs. Virtual accounts are a viable alternative to notional pooling products as no balance set-off by the bank is needed as cash is only located on the current account. This could well build the entire business case for some banks due to their exposure on liquidity overhead.

Offering virtual accounts allows banks to differentiate their brand and increase their ability to retain existing customers and attract new ones. It allows them to future-proof their business by developing new chargeable services. These include notification services, fees per virtual account and those based on empowering clients to use their own data more effectively. This insulates banks from falling FX, operational and transactional fee revenues and helps them prepare for the future of transaction banking.

Features of virtual accounts

Virtual accounts can be used for:
• Corporate liquidity
• Internal funding
• In-house banking
• Reconciliation
• Self-service
• Client money
• Product offerings

One regulation that is directly related to virtual accounts is the liquidity coverage ratio under Basel III. This will create a significant overhead for banks, making it prohibitively expensive for some to offer notional pooling products. Banks are looking to virtual account solutions as a viable alternative to notional pooling.
Can virtual accounts be part of the solution?

Benefits to bank customers

Increase revenue

• Deploy working capital effectively
• Manage risk better
• Improve organisational resilience

Cut costs

• Reduce banking and account management fees
• Reduce staff time spent on payment-related admin

Improve business

• Improve reporting and decision-making
• Improve productivity/efficiency
• Automate repetitive tasks

End-users are more self-sufficient as they can design and structure their virtual accounts in real-time outside the traditional banking environment and processes. A multi-national corporate can have hundreds or even thousands of accounts. Virtual accounts help them rationalise the number of physical banks accounts they have for greater efficiencies and cost savings.

Rationalising bank accounts helps centralise multi-entity cash and improve internal accounting. This in turn helps corporates deploy working capital more effectively, for example making inter-company loans if funds are available, rather than borrowing money at market rates. It also allows them to make the right investments with the liquidity they see and have.

Some virtual account platforms also allow bank customers to customise on-behalf-of structures to manage payments and collections. If the system is self-learning, it can match payments automatically to outstanding invoices. It can also propose allocations based on previous payments and recurring actions, if the payer does not provide full remittance information. This helps automate repetitive tasks, which reduces instances of human error, plus staff time spent on payment admin.

To improve the reconciliation even further, accounts can be created at a payer or even invoice level within a virtual account structure. The payer will then use this account number when the invoice is paid. The account number itself will function as a reference in such set-up, improving the reconciliation to new levels of accuracy.
Selected virtual account management propositions
Selected virtual account management propositions

1. The corporate proposition

Getting paid is crucial, irrespective of business size. As is assigning payments to the correct accounts and knowing cash flow at a glance. However, treasury management is not just about reconciliation. Today’s corporate treasurer is also expected to provide strategic insight and financial counsel to their business. So, having the right tools in place to deploy working capital effectively, manage risk better and improve their business has never been more important.

How virtual accounts help

A highly configurable virtual account solution will support a range of corporate treasury services, enabling banks to offer various propositions for centralised, global treasury management. The functionality includes:

• Payables management, payment factory and payment on behalf of
• Receivables management, collection factory and receivables on behalf of, such as automated funds allocation and receivables reconciliation
• Timely and accurate multi-entity liquidity management
• Optimisation of multi-entity funds, including physical and virtual pooling as a viable alternative to notional cash pooling
• Inter-company lending
• Interest apportionment

The self-service element of VAM means corporates can open and close virtual accounts themselves as quickly as they wish. They can rationalise physical bank accounts, make inter-company loans and calculate interest with ease. A dashboard view and full suite of reports is also available in real-time at the touch of a button for effective decision-making.

The bank opportunity

Multi-nationals will frequently invest in their own treasury management solutions (TMS) and in-house banks, whereupon virtual accounting are essential for success. Large to medium-sized corporates may not wish to build and maintain their own software in-house. Yet they are becoming more sophisticated in their requirements and are looking to their banks to provide additional services.

Banks have a significant opportunity to supply in-house bank services, such as payables and receivables on-behalf-of, via a VAM solution. They can also add value to the client relationship by extending flexibility and self-service around their own in-house bank and on-behalf-of-structures, plus leverage lending provided by the bank.
2. Client money proposition

Segregation of client funds is an essential part of various private and public sector propositions. Asset managers, pension fund and insurance providers need to keep client funds separate to avoid co-mingling of funds. So do property managers, estate agents, lawyers and those administering public sector health and social care accounts.

However, the segregation of client funds must be legally acceptable and adhere to compliance and regulatory reporting requirements. It also comes with a high administrative overhead as it can be time-consuming to open and administer large numbers of individual accounts. As the drive towards instant and open payments starts to bite, regulatory compliance is set to become even more challenging.

How virtual accounts help

Virtual accounts reduce the administrative cost and time to open bank accounts by empowering bank clients to self-serve. Virtual accounts give real-time visibility and operational control of client funds. It also smooths continuous transaction allocations and interest apportionment at the underlying client level. Lastly, virtual accounts improve both liquidity management and compliance with industry regulation, particularly around KYC and KYCC requirements.

The bank opportunity

The client money proposition via virtual accounts is strong for retaining existing customers and attracting new ones. It is also useful in future-proofing banks from falling revenue streams in traditional areas, particularly as a result of self-service.

Virtual accounts move revenue streams from FX, operational and transactional fees towards those that come from empowering customers to use their own data more effectively. These include chargeable notification services and fees per virtual account. In this way, virtual accounts

Deloitte supported a large UK bank in their implementation and have strong views on VAM as an innovative proposition.

“Having supported a large UK based Global Transaction Bank across all aspects of their VAM implementation - including requirements definition, technical implementation, operating model development and platform commercialisation - Deloitte see the flexibility of VAM to rapidly configure and launch new products, enabling Banks to continually innovate and meet new client needs.

Any VAM solution should not only provide a rich set of features and functionality for developing the Client Money proposition but also, due to the highly regulated nature of Client Money, help Banks work through the regulatory and compliance implications of introducing a virtual account proposition. “ Deloitte
Selected virtual account management propositions

contribute towards the new future of transaction banking.

3. Non-banking financial institution and PSP propositions

Virtual accounts can be used for non-bank financial institutions, internet payment service providers (IPSPs/PSPs), white labelled payment and cash management services, and agency banking.

How virtual accounts help

Virtual accounts offer outsourced multi-currency clearing and settlement functionality. Efficient account management (including account opening, payment initiation and reporting) is also possible on a self-serve basis. Automated funds allocation, funds check and reservation as well as FX sharing models are also useful in a number of non-bank scenarios.

The bank opportunity

Banks typically struggle with the high cost of ownership and development of a high-volume payment processing platform. The costs of compliance are also significant. Virtual accounts exist as a viable solution to overcome the back-office challenges of legacy infrastructure and multiple systems. Virtual accounts are typically implemented via an overlay, leaving back-end systems relatively untouched.

Additional propositions

Virtual account management is not a new concept, although many of the ways in which it is being used are new. It is under continual development, and as such its uses will extend and expand. Possible areas for consideration are inward clearing proposition, and services for banks which do not necessarily have local representation, i.e. local clearing access.

Virtual accounting can also be used within project management. If each project owns an account, all the automated reconciliation and allocation tools could be used to assign funds to the right account.

The right virtual account partner will be able to suggest and discuss additional propositions in more detail.
Choosing the right partner to implement virtual accounts
Choosing the right partner to implement virtual accounts

To keep pace with client expectations, regulatory and technological changes, it is vital that banks choose the right technology partner. Here are some considerations when evaluating the right technology partner to implement virtual accounts.

**Standard formats and protocols**

Your technology partner should use front-end overlay technology, which leaves legacy systems largely untouched for quicker time-to-market. If they also use standard formats and protocols, this will make integration to ERP and treasury management systems easier. The right technology partner should be able to get banks live in 4-6 months, following an initial scoping exercise.

**Single platform**

A single virtual account management platform will make implementations of new propositions possible with minimum fuss and waiting time. If your technology partner offers a single platform solution, this obviates the need for complex re-programming or integrations.

Virtual account functional overview

“With time being of essence, Tieto can deliver the VAM minimal viable proposition within 4-6 months. The pace and agile way of working is highly appreciated by corporate banks. We could start with a Proof-Of-Concept through sandbox sessions within 2 weeks after beginning the discussions.” Tieto
Choosing the right partner to implement virtual accounts

Roadmap

Your technology partner should be able to work with you on a roadmap for further roll-outs. These could be across new geographies or propositions. Your partner should also be able to contribute their expertise in co-creating propositions.

Pre-sales support

The right partner should be comfortable and conversant with end-customer needs and have tools which support the bank sales cycle. For example, they should have a business case generator tool, a sandbox environment, as well as proven methodologies for prototyping and fast-tracking use cases.
Summary
Summary

One truism about banking and payments is that they are always changing. Yet while change is the norm, the speed and scale of customer expectations, regulatory and technological change today is anything but normal. Banks must plan their response on their own terms, before they are outmanoeuvred by more nimble start-ups or more far-sighted competitors.

Innovation is one of the few ways to sustain competitive advantage over time. Implementing virtual accounts is a strategic and significant investment in innovation. Particularly as the innovations extend beyond the back-end software to encompass the customer interface, operating model, downstream processes and bank revenues.

However, when considering the cost/income ratio around investment in virtual accounts, the question is not so much can a bank afford to invest. Rather, can it afford not to? Corporate treasurers and client money managers are demanding better visibility and control over cash flow and liquidity. They are demanding products and services from their banks that are faster, more joined-up and help them unlock the power of their own data.

A highly configurable virtual account solution will support banks and bank customers no matter what their strategy or segmentation model. If the solution is based on a single solution, customers can implement in 4-6 months, iterate as desired and overcome legacy infrastructure challenges.

Choosing the right technology partner for any type of long-term, strategic innovation is critical. Banks are advised to evaluate the architecture of any virtual account solution as this will impact not only their speed-to-market, but also their roadmap for future developments. They should evaluate prospective technology partners with regard to their proven use cases and customer references.
About the research
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Payments Cards & Mobile

In business since 1994, Payments Cards & Mobile is an established hub for global payments news, research and consulting. We work with recognized industry experts to provide impartial, up-to-date and relevant information and analysis on every area of payments.

Personal relationships have been the hallmark of our business. We remain committed to working closely with our many long-standing customers and welcome new customers in producing quality business intelligence and providing a variety of ways in which you can consume this information. Our aim is to provide you with the highest quality data so you can position your business and key personalities in this increasingly competitive industry.

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Our in-house research facility is available for short term projects. We specialize in M&A activity, market entry data, country report analysis and statistics. Research reports on banking, payments and mobile payments worldwide.

Topics range across the measurement of efficiency and performance, card and payment service related information, the role of brands in banking and the impact of non-banks such as retailers and FinTechs on the financial services and mobile financial services market.

Payments Cards and Mobile offers specific research on all aspects of banking, card payments, card-less digital payments, Issuing/Acquiring, financial services and the mobile financial services market.

Tieto

Tieto aims to capture the significant opportunities of the data-driven world and turn them into life-long value for people, businesses and society. We aim to be customers’ first choice for business renewal by combining software and services capabilities with a strong drive for co-innovation and ecosystems.

Building on a strong Nordic heritage, Tieto combines global capabilities with local presence. Headquartered in Espoo, Finland, Tieto has around 14,000 experts in close to 20 countries. Turnover is approximately €1.5 billion. Tieto’s shares are listed on NASDAQ in Helsinki and Stockholm.

Tieto Virtual Account Management is a solution enabling banks to offer strong corporate propositions such as in-house banking, liquidity management, internal funding and client money.

Acknowledgements

The study draws on published statistics and on comments from banks and payments industry players. The author thanks various organizations and many payments industry companies for the data provided and the helpful responses to selected questions on Virtual account management.
About the research

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