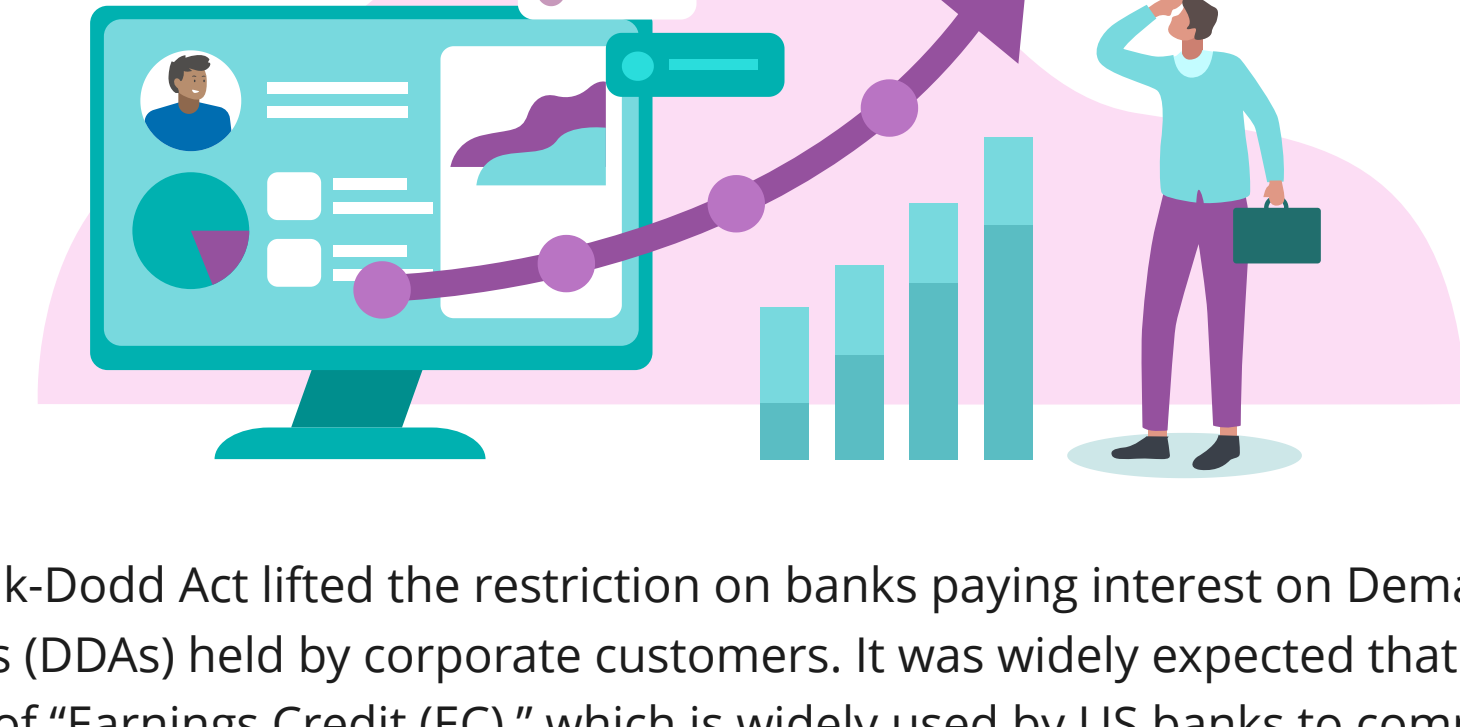


Better Account Activity Analysis Statements and Earnings Credit Enable Superior Customer-Centricity

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Rising Interest Rates Make Earnings Credit and Account Activity Analysis a Priority for Banks

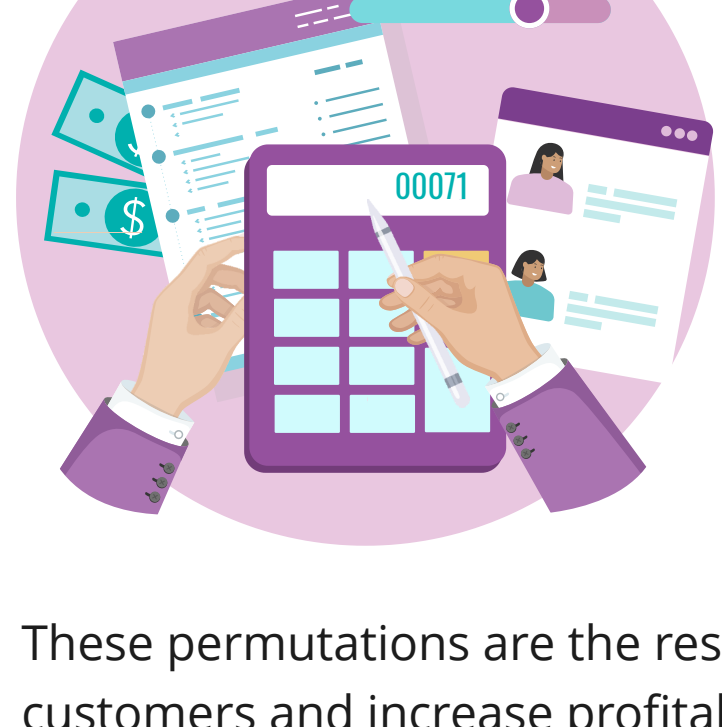


The Frank-Dodd Act lifted the restriction on banks paying interest on Demand Deposit Accounts (DDAs) held by corporate customers. It was widely expected that this would signal the end of “Earnings Credit (EC),” which is widely used by US banks to compensate corporate customers for not being able to pay interest on their DDAs. The EC is essentially a “pseudo interest” figure. However, instead of being credited amount to the customer’s account as “interest”, this amount is adjusted against the fees that the bank charges the customer for services provided during the month. This set off is shown in the bank’s invoices.

For much of the last decade, interest rates remained remarkably low; therefore, the EC did not have any material financial impact on banks or their customers. As a result, banks in the US did not pay much attention to EC. But this is set to change because in recent months, the US Federal Reserve and central banks of other countries have all raised interest rates faster than expected. They have also signaled the inevitability of further upward revisions to combat the multitude of inflationary forces. More frequent changes to interest rates will have significant impact for both banks and their customers.

Competitive intensity in the banking industry has increased in the last decade, incumbents face threats from both new and traditional quarters. Rapid technological advances mean that a bank’s competitive edge is also shaped by how quickly their software systems enable the bank to respond to environmental changes. As interest rates rise, EC and interest on hybrid accounts will become more important for customers. To deliver to the higher expectations with respect to EC, Account Activity Analysis (AAA) statements and hybrid accounts, some banks may need to upgrade their software systems.

Customization and Need for Speedy Responsiveness Make EC and Account Activity Analysis Complex

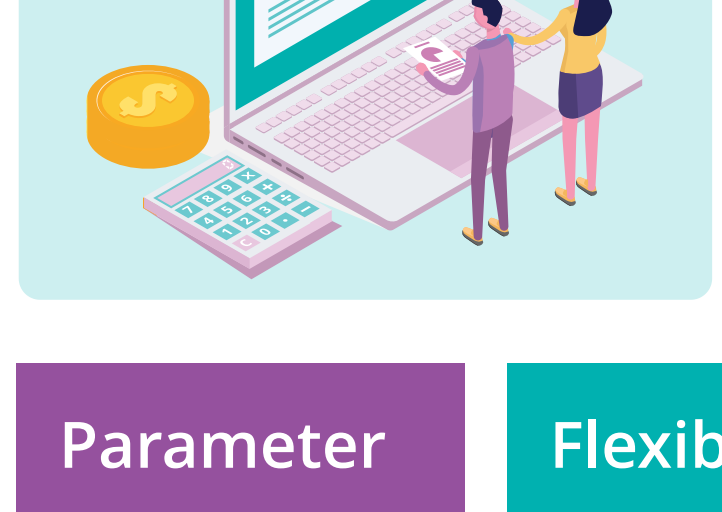


Calculating EC or interest on hybrid accounts is based on a simple formula that takes into account the relevant interest rate, appropriate qualifying balance and the time period. Complexity arises because a number of permutations are possible based on the specific corporate customer.





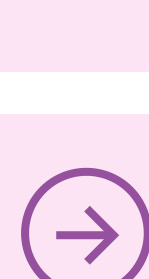

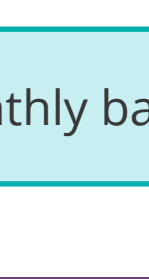
These permutations are the result of the bank’s strategies to attract and retain corporate customers and increase profitability. Customized bundling and pricing based on loyalty, size and profitability of the customer relationship have led to customers being classified in various “tiers.” Different rules apply to different tiers. Each customer consumes a different basket of banking services each month; these baskets too evolve as the customer’s business profile changes.

In addition to being driven by each individual bank’s own growth strategies and governance/risk management requirements, rules may also need to be tweaked based on competitor actions and regulatory changes. Banks must be able to make real-time customer-specific adjustments to how EC and hybrid interest are calculated and applied to every individual corporate account.

The EC And Hybrid Interest Use Cases



For every qualifying corporate customer account, a bank must accurately calculate and apply Earnings Credit periodically. The table below lists the various parameters that need to be considered by a bank in the context of determining EC and hybrid interest for every specific customer account. While the basic formula for calculating EC and hybrid interest is easy to implement, the number of options for each parameter increases the number of permutations.

Parameter	Flexibilities that add complexity
 Account type	<ul style="list-style-type: none"> • Non-interest bearing DDA • Interest-bearing hybrid: there may be special characteristics associated with individual customer account types
 EC interest rate	<ul style="list-style-type: none"> • Standard rate • Varying with size/profitability of relationship, extent of specific product penetration etc. • Determined as a base rate with spread adjustments (+/-, *); the adjustments may need to change with size/profitability of the relationship or relative to overall interest rates in the economy <p>Rates may need to be set for all accounts in a tier or based on an industry, region etc.</p>
 Balance	<p>For each period, the balance on which EC is calculated is also a variable. EC may be computed on the basis of:</p> <ul style="list-style-type: none"> • Average positive balance during the period • Average balance (taking into account both positive and negative balances) • Investable balance, which is defined as absolute average balance - reserve requirement <p>The rule for computing average balance too may need to change over time.</p>
 Reserve requirements	<p>Based on regulations and the individual bank’s governance norms, reserve requirements (also known as Collected Balance) may need to be calculated and aggregated at different levels, such as:</p> <ul style="list-style-type: none"> • Account • Customer • Product • Branch • System <p>Provisions must be made to make changes as may be necessary..</p>
 Frequency of EC computation	<p>While banks typically invoice customers on a monthly basis, the EC may need to be calculated at a different frequency - daily, weekly, quarterly, annually or based on contractually agreed billing schedule. The frequency may also need to change from time to time.</p>
 EC adjustments	<p>Whether the EC is to be set off against the total invoice value or only charges for specific services/products are to be adjusted.</p>
 EC carry forwards	<p>If the EC in a particular period exceeds the invoice value, whether the excess can be carried forward to the next period; what is the maximum number of months for which excess EC can be carried; what is the maximum EC that can be accumulated in a financial year etc</p>

The example below illustrates EC and hybrid interest calculations:

Assumptions:

Qualifying balance for EC: US\$20 Million	Reserve requirement: 0
EC rate: 1%	Days in the month: 30
Monthly bank charges: US\$10,000	Interest rate for hybrid account: 0.75%

EC calculation

Monthly Earnings Credit = Balance * (1- Reserve requirement) * EC rate * (Number of days in billing cycle/Number of days in the year)

Hence, EC for that customer for that month is US\$20,000,000 * (1-0) * 1% * (31/365), i.e., US\$16986.30.

Hybrid interest calculation

Hybrid interest is calculated on the basis of “excess balance” imputed from unused EC. Essentially, this balance is the amount that would have earned interest equal to the excess of EC over monthly bank charges.

Per the above calculation, EC for the month is \$16,986.30.

Thus, the unused EC is US\$16,986.30-US\$10,000.00, i.e., US\$6,986.30

Based on this unused Earnings Credit, excess balance is calculated as follows:

6986.30 = Balance * (1-0) *1% * (31/365)

Hence excess balance is: US\$8225804.84

Hybrid interest credit = \$8,225,804.84 * 0.75% * (31/365) = \$5,239.72

As may be seen from the above example, both for EC and hybrid interest computation, banks will need to make necessary changes to the interest rate, relevant balance and time period for which the interest is payable. The value of these variables will depend on multiple factors. Some changes may need to be applied mid-cycle as well, depending on individual customer contracts or the bank’s risk management and governance policies.

The Account Activity Analysis Use Case

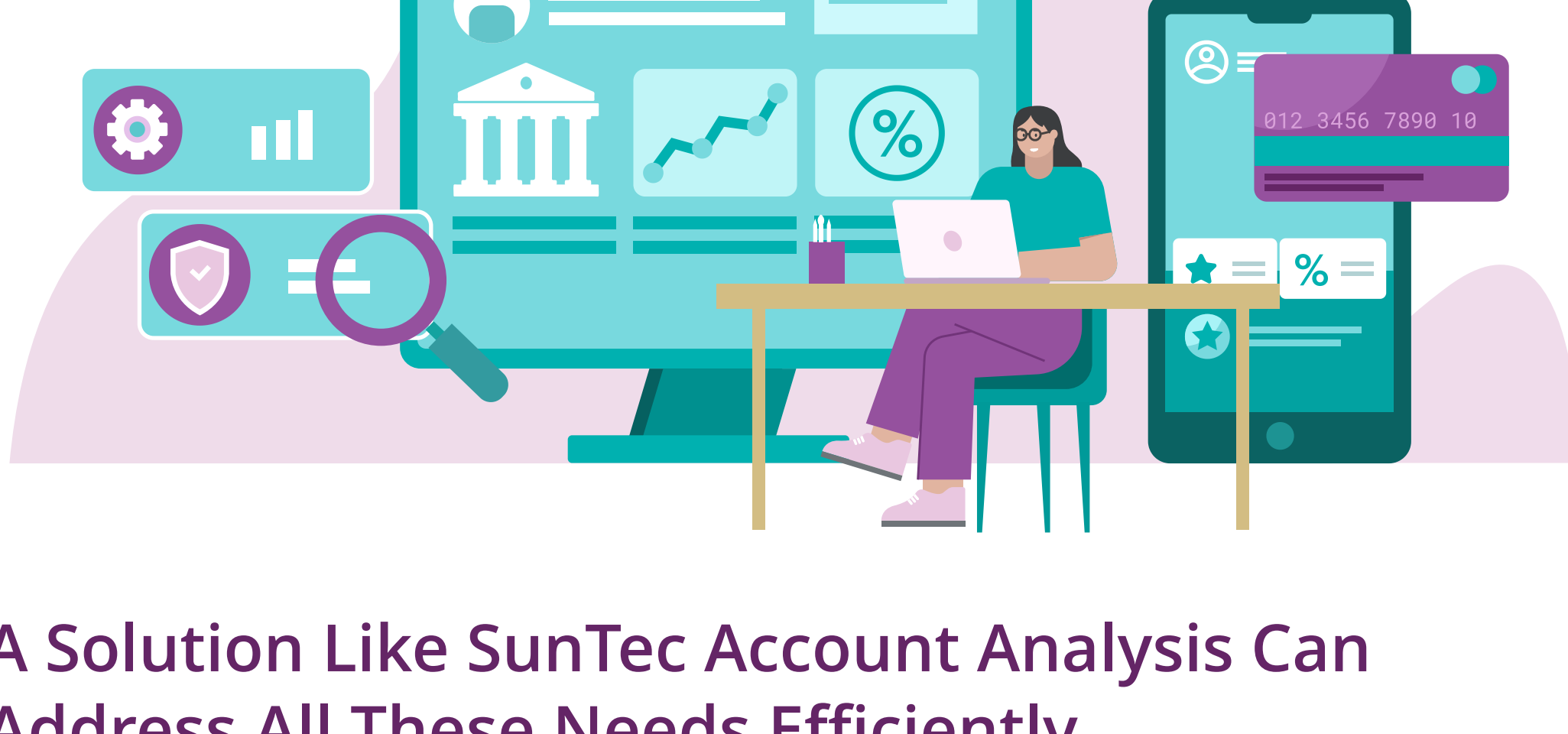


Banks provide a number of services to their corporate customers. These include deposit services ACH, lockbox, float management and other treasury solutions, international payments, online payment etc. Each service has its own pricing structure; often, this varies with the customer, and is agreed during the initial deal or renegotiation stage.

For every corporate customer, banks generate Account Activity Analysis statements each billing cycle. While the format of the AAA statement varies with the bank/customer, it will broadly contain details of what services the customer has consumed during the billing period, unit prices, product volumes, the resulting service charges, applicable taxes, etc. It will also contain details of the qualifying balances for EC and EC amount. It also helps in generating the actual invoice. For the customer, the AAA statements provide drill-down details that enable them to reconcile their invoices (monthly, quarterly or as per agreed billing cycle).

On the other hand, banks use the AAA statements to help understand customer needs and project future revenue. This information is also useful in negotiating/renegotiating deals with customers. Accurate AAA statements are thus a valuable source of data and insights for enabling banks to manage revenue, profitability, growth, and customer relationships.

The complexities explained in the preceding section apply to the generation of the AAA statements as well. From an operational standpoint, the complexity of the task increases because the multiple elements of data that are needed for generating AAA statements are typically dispersed across disparate software systems. This is because most banks are organized based on products and services. When an AAA statement needs to be generated for a customer, updated data needs to be captured, validated and collated from multiple systems. If this process is not done efficiently, customer statements may contain errors; there is also the issue of the time needed to generate these statements and send them to customers.

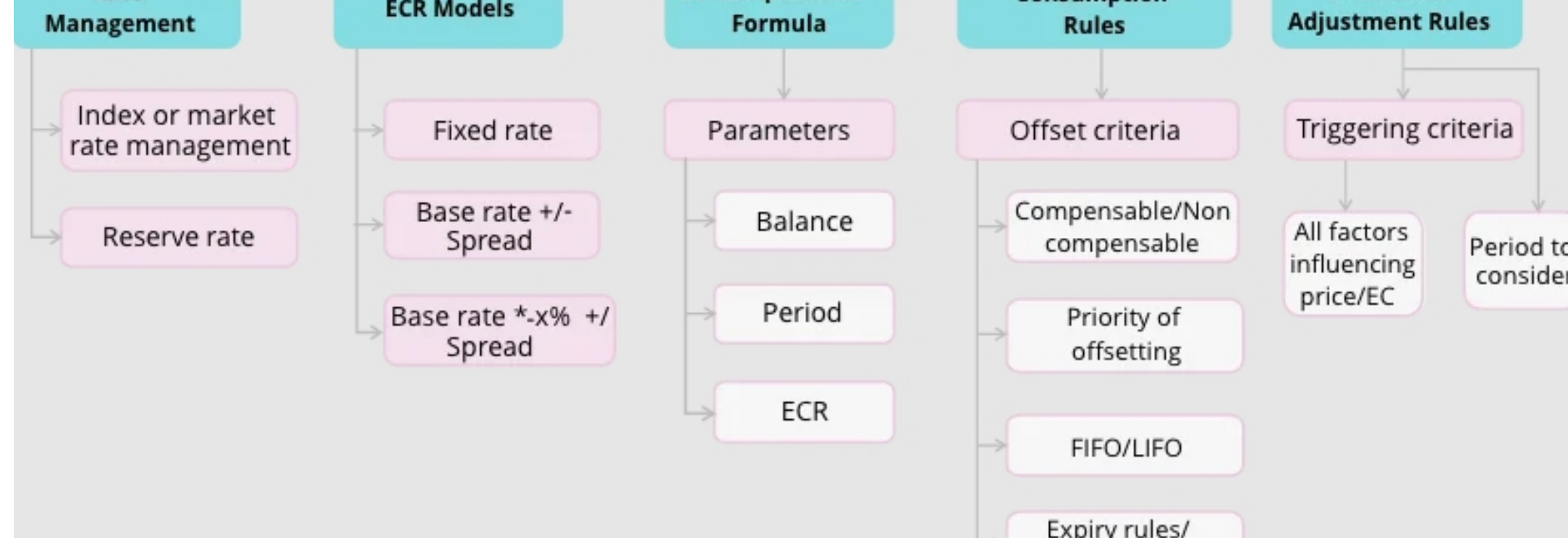


A Solution Like SunTec Account Analysis Can Address All These Needs Efficiently

SunTec Account Analysis provides a robust, secure, scalable solution for banks to easily and conveniently address the complexities described in the preceding sections. The solution’s architecture allows it to be implemented as a wraparound or “middle layer” over existing legacy systems, using APIs to capture the relevant data from multiple systems. It acts as a single point repository for key data and possesses the analytics capabilities necessary for customized pricing and billing, including generation of real-time data-driven insights that enable relevant sales and account management teams to better manage relationships and provide offers that balance customer needs with the bank’s own financial imperatives around profitable growth.

EC and hybrid interest computation and application is simplified because all parameters can be set/modified on the platform; the risk of data not being updated when EC is calculated, or AAA statements are generated is eliminated.

The functional flow for EC/hybrid interest computation is illustrated below.



SunTec has already implemented the Account Analysis Solution in US/North American banks and in banks in Europe.