

## Migrating from Outsourced to Inhouse Netting

*by EuroNetting Inc.*

There are no accurate statistics available on multilateral netting system usage, but perhaps 25% of all corporate multilateral netting systems are being run on a fully- or partially-outsourced basis by a bank or other outsourcing entity. There are various degrees to which a company may be running their netting in-house or outsourced; it is quite common to share parts of the function with a bank provider, in which for example the client's netting participants input or upload their netting data directly into the central system, but the bank then takes charge of the FX trading and settlement processes at the end of each netting cycle.

The remaining 75% of netting users are managing their netting function in-house, using software developed internally, or a commercial netting system product delivered either by a bank or another commercial treasury software vendor.

Within this spectrum of netting system services, EuroNetting Inc. markets the EuroNetting online netting service solely as a client-managed solution. The EuroNetting licensor manages data sourcing, the netting calculations, trading, reporting and of course settlements, in much the same way the treasury department purchases and runs its own treasury workstation package.

EuroNetting's clients have come to EuroNetting over the past 12 years from a variety of sources; several have been completely new to netting, while others have switched to EuroNetting from another provider, quite often a bank-delivered system. In the course of these implementations we have developed a considerable knowledge base of the factors, opportunities, risks, limitations and other issues that influence the practicality and method of bringing the netting function in-house, and we adopt a structured approach to migrations to ensure a practical and successful solution.

Here's a summary of the approach we will take to migrating an outsourced system to in-house:

First, here are some of the considerations that go into determining the practicality of running the netting function in-house. We will address each of these prior to taking on a new client:

- **Manpower**

Although a netting system typically consumes just a fraction of one person's time each month, it still relies on one or more operators being available to manage the critical steps, which occur during the netting cycle. The primary phases are (i) data collection, (ii) trial run, and finally (iii) trading the net positions, reporting and settlement initiation. Each of these phases is clearly defined and can be planned in advance, however remember that there will also be intermittent functions such as table maintenance and setting up new participants; fortunately with a Internet-based service such as EuroNetting it is no longer necessary to add local software maintenance and database backups to this list.

The sum total for a typical in-house operation is generally less than 25% of one person's time each month, but we always makes sure that this person exists and is ready for the new role.

- **Suitability**

EuroNetting clients run in-house systems ranging from just a few participants and transactions per month, up to a few hundred participants and upwards of 50,000 invoices. Is there a limit beyond which a netting system should not be run in-house? The answer is not so much a function of raw numbers; rather, it depends on how potentially large numbers of participants and invoices will be handled. When we see large numbers of records, our goal is to ensure the capability exists to automate data sourcing so that large numbers of participants are not having to individually generate their netting data by re-keying into an online data entry system. This can lead to a high administrative burden for the in-house netting administrator. But these days, virtually all high-volume clients are able to provide their data in files extracted from an ERP system.

When meeting with new clients, we will always give an honest opinion on the practicality of bringing the function in-house, and either suggest changes that need to be made or even decline the opportunity if the situation does not seem viable.

- **Settlements**

Perhaps the biggest change when switching to an in-house netting system is that you become responsible for initiating and reconciling your participant and netting FX trade settlements. When your bank was running the netting system, they took care of the FX trading and settlements, sometimes without you even having to pay for the accounts through which the settlements flow.

Not so with an in-house system! You will almost certainly need a set of multicurrency accounts (1 for each currency in which you will be settling with participants), and a way to efficiently initiate the often numerous list of payables (and incoming currency preadvices many banks require) without having to go down a long list one-by-one. The way to manage this process is through the bank's electronic payment system; EuroNetting includes proprietary payment system interfaces for many bank systems and treasury workstations – and if we don't have the one you need, we will build it in at no extra cost. We will also give knowledgeable advice on the various services offered by banks and on our existing customers' experiences with each one.

- **Credit lines**

You will need FX trading limits with at least one of your banks in order to make the end of cycle trades, and you will also need intraday or overnight overdraft lines for the multicurrency accounts, from which you will be paying out funds before the covering funds will have been identified and posted. Normally these lines will already be in place with your existing outsourcing provider – but make sure they will remain in place after the migration.

- **Cost**

The cost dynamics change in a number of ways when you bring the system in-house.

On the plus side, there will be no more monthly outsourcing fees, and you may hope to get better FX rates by trading the currencies directly, although this often large benefit is quite subtle and difficult to quantify. On the negative side there's the actual cost of licensing the netting service, the monthly multicurrency account maintenance and transaction fees, and manpower cost now that there's someone in-house running the system. (Note, however, that this person was almost certainly involved to some extent each month even with the outsourced system, reviewing reports, approving changes, etc., so the additional workload may not be as significant as you think.)

In addition to these absolute changes in the cost structure, consider also the timing; an outsourced system is generally charged on a month-to-month basis, whereas in-house netting service such as EuroNetting is licensed on an annual basis.

Next, we will ask the new client to review their current netting procedures and consider if there are some improvements that may be made. Netting systems are generally quite static processes which are implemented and then left to run month after month, often being handed over from one administrator to the next over a number of years without any consideration being given to whether the procedure continues to be appropriate. So we view a migration as an opportunity to ask some of these questions:

- **Are the data sources efficient?**

Many systems still use manual data entry as the source of each month's netting data. It's likely the data is being re-keyed from a printout from the accounts payable system, so why not find a way to automatically extract this data directly from the AP system and bypass any re-entry? It may be possible to implement data sourcing procedures on each participant's accounting system, or even source the data entirely from one central system – several EuroNetting clients do just that.

When the possibility exists to introduce automated data sources, we will work with the client to identify and implement these sources, either right from the beginning, or alternatively we can roll out the new system using similar techniques the participants are already familiar with, and then later on introduce some more efficient changes.

- **Are you using all the netting techniques available?**

It's surprising what can be done through modern netting systems. High data volumes with automated aggregation into more manageable balances, hedging, custom reporting, position forecasting, exporting processed data back to the source systems – all these are now possible, and we will review these capabilities to see if any meet your needs.

The next step is the actual implementation and training. This falls into 3 phases:

### **1. Static data conversion and preparation**

All netting systems need some basic tables of currencies, participants, settlement instructions, etc., with which to operate. When migrating from another system, we will provide assistance in retrieving that data from your old provider and importing it into the EuroNetting databases.

In addition, we will encourage you to obtain at least one month's actual netting data from a prior cycle, which we will set up in EuroNetting in order to (1) assure you that the system calculates the same results as the old system, (2) demonstrate how it will look in EuroNetting, (3) get a better idea of the characteristics of your netting. Having prior data available is highly desirable, even if we have to manually re-key it into EuroNetting in the absence of data files.

### **2. Training**

All of the issues and steps discussed above will have been addressed prior to this phase. We will provide comprehensive training on using EuroNetting to manage the netting environment we have already defined and tested; this can be provided on-site and/or online over the Internet according to your preference.

After the installation and training visit, most clients choose to run at least one parallel netting run using both the old system and also EuroNetting, to ensure that the new data sources are both operational and accurate, and to familiarize the netting participants with the new report formats they will be receiving. It's therefore very useful to allow for continuation of the old netting service into the implementation phase of the new system – don't let your previous provider switch off too soon!

### **3. Going live**

The final test of any new netting system is the first live trading date. On this date, you will be refreshing the estimated net currency positions to be traded, then trading the positions, updating and reconfirming the final trade amounts, generating and distributing the netting reports, and finally initiating the settlements.

This critical activity generally fits into a short 2 to 4 hour slot on the morning of the trading date. To make sure everything has been correctly prepared prior to actually locking in any FX trades, we will help monitor your calculations and projected trades on the trading date, and step through each of these procedures with the netting operator to make sure all goes smoothly.

And after that? The next cycle is going to be the same as the first – you've successfully gone live with your new netting system.

EuroNetting Inc.

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