

Sweat and tiers

MANY CORPORATES ARE HOLDING A LOT OF CASH. THE DIFFERENT WAYS TIERED INTEREST RATES ARE APPLIED MAKES A BIG DIFFERENCE TO TOTAL INTEREST EARNINGS. DOUG WILLIAMSON EXPLAINS

Tiered interest is credited at higher rates on larger balances. Calculations can either be (i) stepped or (ii) banded. Banded interest is better for customers, because the higher rates are applied to the entire balance.

Most corporate groups also have large numbers of bank accounts. Pooling balances for interest calculations, where possible, will also give significantly better results for customers.

Group tiers

Let's develop a simple example, based on a recent exam question.

Holdco plc has one subsidiary, Sub A. Both companies have accounts with the same bank. Interest is currently applied on a stepped basis on the individual average surplus balances of £390,000 and £510,000.

Amount (£000)	Interest rate per annum
Up to 250	0.1%
250-500	0.2%
500-1,000	0.5%
1,000-2,000	0.9%

Calculate the annual benefit to the group of introducing a notional pooling arrangement where interest is applied on a banded basis.

Certificate in International Cash Management, April 2015, Q3(a) simplified extracts

Simple and best

The simplest calculation gives us the best result, so we'll start there. Pooling and banding, applied together, results in the highest interest earnings.

Pooling the balances of £390,000 and £510,000 gives a total balance of £900,000. This falls into the 0.5% per annum interest tier.

Banded interest means applying the 0.5% to the entire £900,000.

Annual interest enjoyed is:

$$900,000 \times 0.5\% = \text{£}4,500$$

Our entire group balances of £900,000 are all earning interest at this beneficial rate. These are the grey 'Banded and pooled' bars in each of our two charts on page 57.

Complex and worse

Without the banding and pooling arrangements, the deal is worse for the customer in two ways:

- (1) Credit interest is applied in steps (increments) rather than banded.
- (2) Accounts are treated individually, rather than being pooled.

Stepping down

Stepped interest means only the incremental amounts in higher tiers earn interest at the higher rates. Let's consider Holdco (H) on its own.

Tier (£000)	H balance (£000)
Up to 250	250
250-500	140
500-1,000	-
	390

Only £140,000 earns at the better 0.2% rate (coloured blue). Most of the balance (£250,000) goes into the worst-earning tier at 0.1% (coloured pink).

Many candidates got this wrong, awarding themselves too much credit interest at this stage.

Divided we fall

Now let's bring back Sub A. Without pooling, the stepped balances in A's account are treated similarly to H's. But A is calculated individually, ignoring the account held by H.

Tier (£000)	H (£000)	A (£000)	Total (£000)	Rate	Interest earnings (£)
Up to 250	250	250	500	0.1%	500
250-500	140	250	390	0.2%	780
500-1,000	-	10	10	0.5%	50
	390	510	900		1,330

Interest-earning power is substantially reduced. Most of the total group balances now earn at the very worst rate of just 0.1%.

Only a small increment is earning interest at the favourable rate of 0.5%, compared with the entire £900,000 under banding and pooling. This results in much lower interest earnings – just £1,330.

These are the multicoloured 'Stepped' bars in our two charts on page 57.

Handy benefit

The annual benefit of pooling and banding is £3,170. This is the difference between the £4,500 earned under the better arrangements, and £1,330 under the worse ones.

This kind of calculation is important in practice and frequently examined. Getting quick and confident at them needs your focused effort.

Sweat it out

I recently discussed study focus with GK, an MCT graduate and a sponsoring employer. He attributes his own study successes to:

- Starting early;
- Family support;
- Transferring skills; and
- Making sacrifices.

Start early

When studying, I put an hour in early – usually 6-7am, to make sure I'd always got something done should the work day get away from me. Where possible, I'd also book an office for an hour at lunchtime to study.

Family support

One Easter, before the April sitting, I needed the long weekend to study. To support my effort, my wife and children went on holiday. I sat, properly under exam conditions, eight past papers, morning and afternoon in the correct order and exact time slots on consecutive days from Good Friday to Easter Monday. I also read through my scripts critically against the model answers in the evenings. It was exhausting! But absolutely worth it.

Transfer skills

I'd applied these practices successfully to earlier studies, on advice from a colleague I respected. It was a no-brainer to transfer them to my ACT work, knowing:

- It was for a limited period; and
- I really wanted the qualification.

I got clear passes in both my MCT exams.

Sacrifice

All this led me to have little sympathy for any of my team members who claimed they "hadn't been able to fit in the study required". That's simply unacceptable. You really do have to decide whether you want the qualification enough to make the necessary sacrifices, or not. Particularly if your employer is paying.

GK, former director, Big 4 advisory firm

One more company

Let's follow this good advice by pushing on with our earlier group case study. We'll introduce one more group company. Say our new company has a surplus cash balance of £245,000.

What's the annual benefit of pooling and banding now?

Banded and pooled

Total pooled balances are now:

$$0.39m + 0.51m + 0.245m = \mathbf{\pounds 1.145m}$$

This total £1.145m falls into the tier above £1m, and the interest rate of 0.9% in our 'Group tiers' table, on page 56.

Banding means the 0.9% applies to the entire £1.145m.

So, interest earnings are:

$$1,145,000 \times 0.9\% = \mathbf{\pounds 10,305}$$

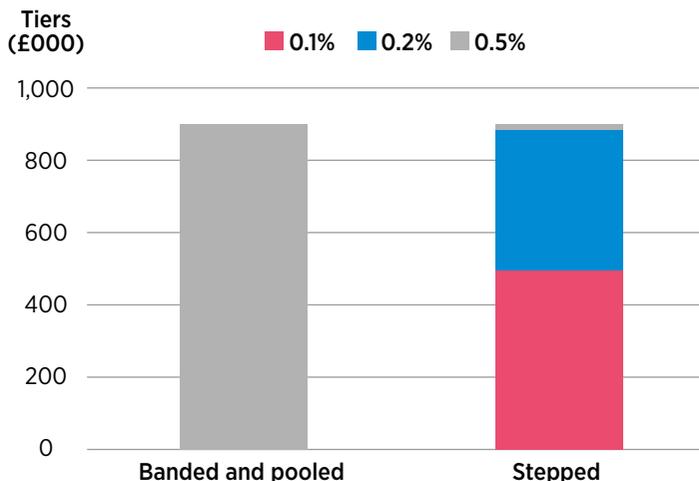
Individual and stepped

Now, turning to the individual and stepped arrangement – on this basis, the additional £245,000 is all in the very lowest tier – below £250,000 – earning just 0.1%.

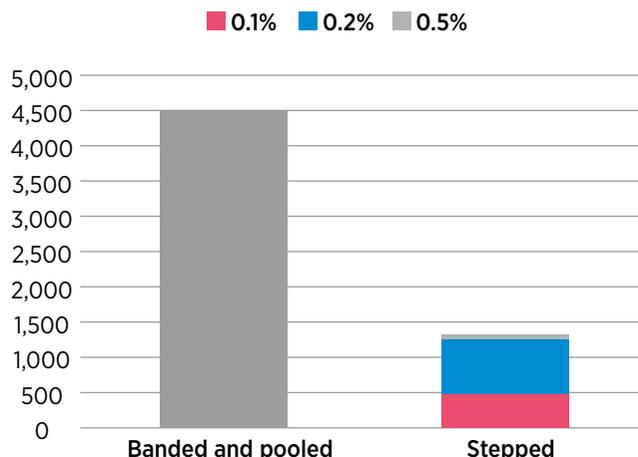
Interest on this incremental amount is:

$$245,000 \times 0.1\% = \mathbf{\pounds 245}$$

Banded boosts earning power of £900k surpluses



A big step down: interest earnings £1,330



Added to the £1,330 we calculated before, total interest earnings under the individual and stepped arrangements are now:

$$1,330 + 245 = \mathbf{\pounds 1,575}$$

More rewards

The total benefit of pooling and banding becomes £8,730. Again, this is the difference between the handsome £10,305 now enjoyed under pooling and banding, and the rather derisory £1,575 without them.

Well worth investing a little time and sweat to understand. Having understood, make sure you always negotiate with your bank for the most favourable basis. Banded will always be better. Notional pooling will also be better, where permitted by local regulations and offered by the bank.

HELP FOR ACT STUDENTS

Download further useful study information from the student site you are assigned to: either the Resources area of the ACT Learning Academy at learning.treasurers.org or the Exam Tips area of the ACT Study Site at study.treasurers.org

With many thanks to Paul Cowdell and Michèle Allman-Ward for all their valued suggestions.

Doug Williamson is a treasury and finance coach

