TIME TO TAKE THE PLUNGE

DESPITE THE SINGLE CURRENCY, EURO CASH POOLING REMAINS A SIGNIFICANT CHALLENGE FOR TREASURERS. IN THE FIRST OF TWO ARTICLES **BOB LYDDON** LOOKS AT SETTING REALISTIC GOALS.

The trading pattern of any international firm will cause it to make and receive payments in different currencies. In the past in Europe this has meant the company holding many bank accounts outside the UK, both because its subsidiaries exist there and also to avoid the high costs of cross-border payments. As a result, companies have held bank balances:

- in the names of different legal groups;
- in various countries and currencies;
- that are positive and/or overdrawn;
- which have attracted low or no interest on positive balances; and
- which have been charged high debit rates on overdrafts.

Now that many of these balances are held in euro, the natural desire for companies is to pull the balances together into one interest position, and there are a number of ways to achieve this, as follows:

- The company could set up a treasury centre (or in-house bank) into which all its balances are moved – whereby the treasury centre itself can take in cash from subsidiaries that are in surplus and lend it out to subsidiaries that are in deficit. The centre thus achieves the offset on its own balance sheet. If it has just one account, it takes Subsidiary A's deposit into it and makes the loan to Subsidiary B out of it and the company is square. A company with the scale and staffing to operate such a system itself may not need banks' products.
- The firm might want to consider notional pooling, where the net interest result is improved without the balances moving.
- Or use an automatic sweep of funds between bank accounts, usually to bring many of the balances to zero.
- Or use manually initiated funds transfers, a technique which brings many of the balances near to zero.
- Or a combination of the above techniques can be used.

PITFALLS. Simple as the objective may sound, their achievement can be hindered by a number of obstacles. There may be legal restrictions on companies in certain countries of incorporation participating in such a scheme, then there are tax issues, such as deductibility of interest, withholding tax, stamp duties, and the need for relationships to be priced on an arm's length basis. The costs associated with holding balances in banks at all (central bank reserve costs, deposit insurance costs) also need to be considered, as do exchange controls, which can act as barriers to allowing residents and non-residents to participate in the same scheme. Lastly there is the need to report certain types of transactions to central banks.

All these potential problems need to be reviewed under each technique, no matter how simplistic it may seem. For example, with notional pooling there are no operational links between related companies, and no funds move between their accounts, but the contracts make it perfectly clear that the companies are connected. As such, notional pooling will always carry an element of risk that a scheme set up to achieve tax, legal and accounting treatments that are bank-to-corporate is re-classified by the authorities as a corporate-to-corporate scheme. This risk is made imponderable by the scarcity of specific case law in this area. It is heightened, for example, where a notional pool takes on set characteristics such as the amounts involved and which participants are in surplus and deficit. Then the relationships within the pool are likely to be treated for tax reasons as if a zero-balancing had been in place, and the only difference for the company would be the daily accounting.

BANK RELATIONSHIPS. The contracts for bank products in euro cash pooling can pose particular issues, as follows:

- the bank effectively takes security over the company's cash;
- the bank puts in place credit lines for the subsidiaries that require overdrafts, either intraday or overnight;
- this may conflict with other financing documents the company has in place, which contain security provisions and/or negative pledges and/or limitations on the amount of credit lines that can be established and who with; and
- if the pooling bank is not the main bank, it may conflict with agreements and/or policies regarding ancillary business.

TABLE 1
WHAT'S THE TYPICAL ROUTE FOR YOUR COMPANY

Company type	Preferred solution	Bank service needed	Service providers
Top multinational	Own treasury centre	Local accounts for subs; local or central accounts for the treasury centre; sweep to connect the accounts.	Large local banks where the company has enough clout to arrange the terms it needs.
Medium multinational	Pan-European pooling	Local and central accounts for all entities; local accounts are swept to a central location; notional pool may exist at central location too.	Network banks – all accounts held in their books, but local subsidiaries may still use local banks.
Large corporate	Multibank pooling	80/20 service that gives a result in spite of the restrictions imposed by keeping with the current bank group.	Existing banks that the firm cannot switch away from, working under the main bank.
Mid corporate	Most payments into/out of central accounts	Local accounts held only when really needed, and then swept into central accounts daily or periodically.	Main bank, using mainly partners, because house banks to mid corporates often do not have a pan-European network.

Another complication is that these types of schemes can only be offered by banks that have properly geared themselves up with their own branches, subsidiaries and partners to handle euro cash pooling – and there are not too many around. So for treasurers thinking of going down this route, it is worth considering the following:

- Does your company fit within that bank's target market definition? If not, it is pointless going any further.
- Even if it does appear to fit the definition of the branch selling the service, what about your company's subsidiaries? Do they fit any definitions imposed by other parts of the bank?
- What will be the company's position with the pooling bank once it has moved all its business there? Small fish everywhere? Well-served in a few countries and overlooked elsewhere?
- Will the company pass the bank's credit acceptance criteria for any credit lines needed within the structure? Does the parent have to guarantee all these credit lines?
- Is the bank your company's current operating bank in all the places where accounts will be opened in order to service the arrangement?
- If not, will the bank make it a condition that all, or a large part of, the firm's operating business is moved to that bank (or its partners) in those locations? Are they capable of handling that business? Even if they can, is this feasible operationally, what will it cost (especially if moving from a local to a foreign bank there), and will this disturb existing relationships?
- Does your company have local banks that will lose out and upon whom you are dependent for credit and/or have agreed to give this business to?

MARKET SEGMENTATION OF CORPORATES... Broad generalisations are often misleading, but in this case they can be helpful in working out which solutions are typically used by which types of companies (by the scale of their needs, the options available to them and so on), as can be seen in *Table 1*.

...AND BANKS. The Association's ECPWG has, as one of its objectives, to obtain current information about what types of customers fall within the different banks' target markets. The exercise also aims to define which banks are in the market with a proposition where the in-country coverage is delivered through their own operations (known as 'network banks') and which banks use partners. Given that the scope of the exercise is European, ING and BNP Paribas immediately spring to mind as network banks with significant branch coverage, as do Deutsche Bank, Citibank, BankAmerica, ABN AMRO, JPMorgan and HSBC.

Even where a strong network is in place, the network banks also supplement their own coverage with partners, so the key questions become: where in-country accounts form part of the solution, in which banking entity are they opened, and how robust are the IT and operational arrangements allowing the account to participate in the scheme?

REAPING THE BENEFITS. Treasurers will find pooling a great help in controlling their company's finances. Among other things, there will be a reduction in net interest paid, a reduction in balance sheet size, and possibly a better rating and lower interest spreads. The company should certainly have more credit lines available because they are not tied up supporting local overdrafts. Finance costs become more transparent, and funds easier to control. However, there can be many pitfalls and it is important not to waste time on looking at options that will not work for your company. So make sure you explore all the issues before taking the plunge into the euro cash pool.

Don't forget to read next month's article, the second in this series, where we will suggest a process for assessing alternative approaches to euro cash management.

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