Crossborder euro cash pooling: fact or fiction?

Anne Querée surveyed eight cash management banks and asked treasurers about the products and services they would like to see in the market.

Treasurers have used the introduction of the euro as a catalyst to establish euro concentration and pooling structures, designed to improve the corporate balance sheet by offsetting debt against surplus cash and to improve profitability by maximising interest earned across operating account balances in euros.

Banks have not been slow to offer treasurers the opportunity to manage and concentrate their liquidity across Europe. However, crossborder notional pooling (the offset of credit and debit balances on accounts wherever they are held, without movement of funds) is still hard to achieve. *The Treasurer* has investigated what products and services banks are offering to their customers and which products and services some of their corporate customers would like to see in the market.

This article concentrates on the euro, but also includes some observations on pooling and cash management in other regions and currencies as well as trends towards global cash management.

Key findings

Between them, the banks surveyed are targeting the largest, global and multinational companies as well as medium-sized organisations with their services. Across the board, they reported a strong appetite among their customers for cash concentration and/or pooling services for euros and other currencies. The introduction of the euro has been a key driver of recent activity.

All the banks offered the main concentration services such as pooling and sweeping arrangements (domestic and crossborder). RBS does not yet offer automated sweeps, although it is working to develop this service. RBS differs from the other banks in our survey in that it does not have a branch structure outside the UK – it is, however, able to provide crossborder services through its membership of the IBOS group of banks.

Improved reporting services, including, in some cases, introducing web-based reporting, was a common goal for development

The key differences between the bank offerings appeared to be in the area of crossborder notional pooling. Three of the banks – ABN AMRO, Citibank and HSBC – said they had plans to introduce a crossborder, notional pooling service in the future, although some seemed closer to achieving this than others. RBS would like to offer notional pooling and is currently researching the possibilities. Three of the banks are already offering crossborder notional pooling in euros, or for euros plus other currencies, as explained below. Some banks are offering end-of-day sweeps between regions for dollar balances.

There was less uniformity of response when we asked the banks about treasurers' key requirements in these areas. The most commonly-cited requirement was for improved reporting capabilities.

All the banks surveyed either currently offer or expect to offer automated investment options in future. Improved reporting services, including, in some cases, introducing web-based reporting, was a common goal for development. The banks are aware of the need to provide more help in tracking the intercompany loans created by sweeping.

Most used structure: automated crossborder sweeps

All the banks we spoke to agreed that concentrating euros in a central location via automated crossborder sweeps was the most commonly-used structure. These sweeps can be set up to zero or target balance the operating accounts in the country, either by debiting or crediting the local account. Deutsche Bank highlighted what it refers to as 'conditional balancing', enabling the treasurer to drive the sweeps through some additional parameters. For example, it might be desirable to specify the amount to be moved (as opposed to the balance to be left) to take account of intercompany financing restrictions, or to specify a maximum or minimum balance for sweeping. HSBC stated it

About the survey

During February, *The Treasurer* sent a questionnaire to eight banks, a mix of global and regional players, asking about the cash concentration and pooling services they are providing and what they plan for the future. These were: ABN AMRO, Bank of America, Citibank, Deutsche Bank, Fortis Bank, HSBC, JPMorgan (the recently merged JPMorgan and Chase, and The Royal Bank of Scotland (RBS). The questionnaire was then followed up with a series of telephone interviews.

In addition to the bank survey, we also spoke to a number of treasurers about their experiences and needs in this area.

Our survey was not, of course, exhaustive. Other articles in this Spotlight cover some services offered by a number of other banks. ■

has plans to allow customers to specify the order of sweeps between different accounts.

In most cases, after sweeping, the centralised funds are concentrated into a single treasury account for interest calculation. Sometimes funds are swept to mirror accounts (separate accounts in the name of the treasury entity allocated to each local operating unit) or reference accounts (owned by another legal entity, but with the local operating unit having use of the funds) at the central location, and then notionally pooled.

A point for caution raised by some companies in this respect is where accounts with local banks are to be debited to parallel accounts in-country with an overlay (concentration) bank, these transfers must sometimes be made manually by the corporate treasury.

On occasions it seems, local banks are reluctant to set up end-of-day transfers, and automated sweeps may be impractical due to difficulties in calculating precise balances because of differences in value dating, late entries, local charges and so on. In addition, some overlay banks, keen to get the local operating business, appear to make quite high charges for such domestic sweeps.

Another issue raised by concentration to a single account is the extra administration created by the resulting intercompany loans. In almost all cases, banks are now willing to provide some level of help with this. However, not all banks have yet fully integrated this information with their electronic banking services or web offerings.

Crossborder notional pooling is available on a limited basis

Concentration, then – with or without a pooling structure at the centre – is the most commonly-implemented solution – but ask treasurers what they would really like and in the majority of cases they respond that they would prefer to leave the funds on the operating accounts in-country, while still receiving interest benefits for compensating balances.

There are two main reasons for this. The first is that the administrative burden of intercompany loans, referred to above, is avoided. The second is that costly crossborder sweeps are not required. Generally, the treasurers we spoke to thought notional pooling would be the simplest solution and

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therefore preferred by the treasury and local operating companies alike.

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Three of the banks we surveyed (Deutsche, Fortis and JPMorgan) do offer customers the option of pooling the balances on separate, local operating accounts (that is, without any movement of funds), but only JPMorgan offers full offset on this basis, the others offering an interest optimisation agreement.

Obstacles

Crossborder notional pooling structures are definitely still the exception rather than the rule, with banks citing regulatory obstacles. It is clear that legal and tax obstacles and uncertainties exist. And company structures can raise problems. For example, if an operating unit is a separate legal entity it may not be possible to include it in pooling arrangements in some countries. As one commentator pointed out, many treasurers make the mistake of believing that notional pooling means that, as it appears that the bank is paying and charging interest, then it does not need to worry about thin capitalisation and withholding tax. This is not the case, though – the tax authorities will look at the complete structure.

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Furthermore, Robin Easton, Vice President of Global Treasury Services at Bank of America, points out that a company operating a commissionaire structure might prefer sweeping and concentration to pooling, while the culture of the company – whether it is willing to give cross guarantees, for example – will also have a bearing on the choice of structure.

As more banks and businesses have investigated possible structures, the more sensitivities seem to emerge. Question marks over the validity of cross-guarantees in some jurisdictions in the event of insolvency are proving particularly worrying to banks, it would seem.

Richard Martin, Head of Product Management, ABN AMRO, provides a useful summary of the regulatory and tax difficulties in respect of both cash pooling and cash concentration (*see Figure 1*).

A possible solution to some of the current difficulties with the more traditional cash pooling structures is EuroTrea$ury, a bespoke solution developed by PricewaterhouseCoopers and offered in conjunction with HSBC. According to John Nicholas, Senior Product Manager, HSBC, the special purpose vehicle (SPV) overcomes some of these difficulties, such as pool benefit allocation, withholding taxes and thin capitalisation. Full details on the SPV, however, are subject to a confidentiality undertaking.

Welcome news is that an EC forum group, with a membership made up of representatives of various European banks, is aiming to address issues relating to harmonising the requirements underpinning crossborder financial services (specifically, pooling and account opening).

But if three banks can offer crossborder notional pooling (even if it does mean making allowances for some 'local difficulties' in certain countries, such as France, where interest cannot be earned on operating accounts, and

Case study – crossborder, notional pooling for euros

The Peninsular and Oriental Steam Navigation Company (better known as P&O) saw the introduction of the euro as an opportunity to improve working capital management across its operations in Belgium, France, Germany, Italy, the Netherlands and Spain. Shane Waldron, Manager, Project and Structured Finance at P&O, responsible for the task, wanted to reduce the high number of local bank accounts, negotiate banking fees on a group basis, automate as much as possible, and bring local liquidity management under the supervision of the treasury.

The important work of managing the changeover of point of sale systems to reflect the new currency was the first priority for the company at year end 1998. Then, in February 1999, P&O put its euro cash management out to tender to five banks, specifying a crossborder notional pool as the preferred solution.

Only one of the five banks – Fortis Bank, which had a pre-existing relationship with P&O in the Netherlands – was able or willing to provide a solution in line with P&O's requirements. The other banks were all offering cash concentration solutions, according to Waldron. He explains: "I felt some of the banks failed to address our objectives". After considerable further work to ensure the solution proposed by Fortis Bank would be watertight, P&O awarded the bank the mandate in April 1999.

The solution is a notional pooling structure which includes all the countries mentioned above, and additionally some euro accounts in the UK. The euro balances of the French operating companies are concentrated into a mirror account in their name in the Netherlands, in order to participate in the pool, but all other balances remain in-country.

Overall, the number of local operating accounts has been reduced from about 110 across 32 banks, to roughly 40. These local operating accounts are target balanced, with transfers to and from a local account with Fortis Bank in each country being made on a daily or weekly basis, as appropriate.

Each month, two interest calculations are reported – the interest due or to be paid on each of the in-country pool accounts and the interest on the net position of P&O Group. The difference between the two – known as the 'bonus' – is re-allocated to the individual companies by Fortis Bank according to the credit or debit position of each.

Waldron says that the new structure is capturing about 90% of the funds in the countries included and generating significant total savings for the group, without incurring the additional crossborder sweep costs (except for the French balances), or the work involved in administering intercompany loans.

This is a significant point for P&O, since the holding company in the Netherlands has a staff of just two.

When time allows, Shane Waldron wants to explore the possibility of including the dollar and sterling flows in a cross-currency, crossborder notional pool. ■

FIGURE 1

Regulatory and tax difficulties

There are regulatory and tax difficulties in respect of both cash pooling and cash concentration, as follows:

- there is a lack of harmonisation among European banking regulators with respect to permitted notional pooling jurisdictions;
- differences in corporate and insolvency laws among the European jurisdictions;
- inordinate amounts of time and money are being spent on obtaining legal advice, and on the drafting and negotiation of legal documentation;
- significant business-impeding uncertainty exists with respect to corporate power (for instance, is a cross-guarantee lawful and binding under the jurisdiction's corporate laws and under the company's constitution), corporate benefit (under which conditions are pooling guarantees and intercompany lending to the benefit of the corporation and therefore legally viable) and mandatory insolvency laws (is set-off achievable upon insolvency?);
- differences in tax legislation among the European jurisdictions lead to a substantial non-productive investment in measures to minimise their impact;
- differences in withholding taxes, stamp duties, thin capitalisation legislation and the tax treatment of the settlement of (notional) pooling interest impede crossborder pooling business;
- restrictions on intercompany lending (for instance, Denmark, Greece, Austria);
- restrictions on the payment of credit interest on current accounts (France); and
- varying rules with regard to central bank reporting. ■

Source ABN AMRO

even if it is on an interest optimisation basis), then why don't others?

Aside from the very real regulatory obstacles, there are two possible explanations: one is that banks prefer to offer concentration because this provides them with more transactional business.

Another, suggests Paul Emmett, EMEA Liquidity and Investment Group Executive, JPMorgan, is that where banks rely on in-country, in-branch systems as opposed to a single technology platform, they may be managing multiple positions and information flows. JPMorgan has a centralised clearing and treasury environment in Frankfurt, with all branch processing taking place in a shared service centre in Bournemouth, providing a particularly flexible technology environment, he argues.

Crossborder, notional pooling for euros – a case study

Our case study (see *above*) describes how one firm, P&O, has implemented crossborder notional pooling and achieved significant savings.

Other treasurers we spoke to had also explored the notional pooling option, but ended up with a cash concentration solution, which, according to one, "achieves the benefits, but with a lot more effort".

In this case, the company in question had been offered a partial notional pooling solution, but since it excluded five of the euro-in countries, and the company did not want to implement two different strategies, the cash concentration solution was chosen.

Causes for concern

One piece of advice offered was for treasurers to have a definite structure in mind ahead of discussions with banks, to avoid finding themselves immediately in an "any way you like as long as it's concentration" situation.

But, much as treasurers may prefer pooling to concentration in theory, for the reasons we have already discussed, it is too simplistic to polarise the debate into pooling versus concentration.

As Klaus-Bernd Schalkowski, Head of Liquidity Management, Global Cash Management, at Deutsche Bank, sees it: "Services chosen by customers sometimes turn out to be sub-optimal with regard to the expected benefits. Depending on his/her evaluation about costs and revenues, treasurers need to choose from a range of solutions – each offering different cost-revenues ratios – in order to optimise the profits in each individual case.

Costs of internal procedures necessary, for example, for the administration of liquidity management solutions, also have to be taken into account."

Few would disagree. What treasurers appear to be concerned about is that sometimes, for a variety of reasons, they do not have the opportunity to exercise that choice – for example, the choice between slightly lower savings overall, and less administration for the treasury.

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Looking forward

It is clear from our survey that more crossborder euro and crosscurrency notional pooling options will be available to treasurers in the near future. Citibank, for example, is currently building a global platform for notional pooling and ABN AMRO says it will also introduce an offering.

A second clear trend is the development of enhanced reporting tools for liquidity management. These take two forms:

- first, intraday reporting of the movements and concentration/pooling, balances, as well as interest apportionment and allocation, will increasingly be integrated with banks' electronic banking services.

  Banks already provide this in some form, but several are improving the presentation and rolling it out as part of enhanced web-based services; and
- second, specific shadow administration services for intercompany loans delivered via web based reporting.

  ABN AMRO is developing such a service and Deutsche Bank is extending its internet-based services to help corporate treasurers with the internal management of complex crossborder liquidity management structures, including administrative tasks, planning and cash forecasting.

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A third trend is towards more automated investment options, providing treasurers with opportunities to put those larger pots of euros to work.

Jose Franco, European Liquidity Manager at Citibank, says: "As European treasurers move away from managing each country as a separate position they are becoming increasingly interested, like their US counterparts, in automated investment options, either as part of a concentration or pooling structure, or without, depending on their needs."

Finally, on the horizon is global liquidity management. Some companies are already including a range of Asian and European currencies with dollars in notional pooling structures. And some of the larger banks already have significant end of day business moving dollars from Europe to the US, extending the trading day and the investment options. The banks expect these trends to develop – albeit slowly at first.

It might take care, compromise and tenacity to set up the 'optimised' euro liquidity management structure for a company, but, as treasurers and banks both agree, once it is done the savings are significant, year on year.

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RESPONSE

This article raises a number of issues which readers may wish to respond to. We would certainly welcome your views.

Please address any correspondence to:
mhenigan@treasurers.co.uk or fax 020 7213 0723.
If you wish to respond in time for the May issue, you will need to notify me by Monday 9 April. The deadline for receipt of your letter is 11 April. We will, of course be able to publish correspondence in a later edition.

Mike Henigan
Managing Editor