DIFFERENT APPROACHES TO EUROPE

BRIAN WELCH OF THE USERCARE TREASURY CONSULTANCY REVEALS THE FINDINGS OF THE ACT'S STUDY INTO HOW MAJOR BANKS ARE MEETING THEIR EURO CASH MANAGEMENT NEEDS.

During 2002, it became clear that the introduction of the euro had not necessarily resulted in more efficient cash management structures between the different countries in the EU. In particular, the concept of notional cash pooling, which is familiar to nearly all UK treasurers for their sterling cash management, was not widely available for euro management in either individual regions or across borders of the different euro countries.

The issue was compounded by the fact that, contrary to earlier expectations, there has been only very limited cross-border consolidation of European banks, confined to the Benelux and Scandinavian countries. Indeed, there is only one bank that appears to be able to offer full service banking throughout the EU, without using partner and correspondent banks.

An earlier, limited study in November 2001 identified that up to 44% of larger companies managed their euro balances in the euro countries in a centralised manner, but while the larger companies had succeeded in achieving a solution, this did not appear to be the case for all corporates.

WORKING GROUP. The Technical Committee of the Association of Corporate Treasurers (ACT) therefore established a Euro Cash Management Working Group to attempt to identify the different solutions that were being offered to companies, by inviting the major banks to describe the solutions they were able to provide.

The Working Group contacted 14 different banks that were perceived to be providers of euro banking across Europe, comprising three US banks, four UK clearing banks, and seven eurozone banks. We have not identified the individual banks, because they each have a different approach based on their location, which may determine the structure of their product. In addition, the solutions themselves have involved considerable expense, both in terms of legal and tax advice, and the systems developments.

The problem with the management of euro balances over the entire EU is that, while the euro is a single currency, each individual country still has its own central bank, specific banking rules, legal requirements and withholding taxes. As a result, each of the banks have needed to develop different solutions that work from their regulatory base. There are two main solutions, provided by the banks, using notional pooling, and zero balancing.

Notional pooling is the offsetting of multiple balances at a single bank, for the purpose of calculating interest on the net balance. There is no actual movement of funds. Interest is usually debited/credited to a designated 'master' or header account. Where the accounts are held in different countries, however, more care has to be taken to compensate or charge each account on a calculated basis. Interest enhancement is similar to notional pooling.

Zero balance (or target balance) Sweeping is a method of cash concentration, where the balances on different operating accounts are swept to/from a 'master' account to leave a zero balance or target (residual) balance at the aerating accounts and an aggregated balance on the master account.

- **Notional pooling** (see above box for definition) is the preferred solution for companies so that aggregate value of their euro balances throughout the EU can be utilised. It not only maximises the interest earnings (or minimises the interest cost), but also reduces the need to make cross-border euro payments, which continue to be more expensive than euro transfers within a single member country.
- **Zero balance (or target balance) sweeping** (see above box for definition) can be provided more easily by transferring (sweeping) balances to a central location, where the balances can be combined and invested centrally. A key issue is what balance is transferred and when. If the closing balance is transferred on the same day and invested, the effect is similar to pooling, except for the cross-border transfer costs and the rate of interest earned. If the closing balance is transferred the following day, the transfer costs remain, but the effect may be

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less efficient than notional pooling, depending on the cashflows of the company concerned.

- An **overlay structure** is frequently used to combine pooling and sweeping where a single bank has branches in various countries but does not provide full domestic banking in all of them. In this structure the local bank used for domestic transactions, transfers surpluses (or funds cash requirements) to/from the overlay bank within that country, which then notionally pools its balances on overlay accounts to provide a multi-country solution.

RESPONSES. The responses indicate that there is a very broad pattern between the various banks as to where they can provide notional pooling and zero balance sweeping to a concentration account. London is the most frequently used location for the concentration account, for the following stated reasons:

- positive approach to fiscal, legal and regulatory issues;
- access to excellent euro liquidity and payments networks;
- most of the banks have major operations in London; and
- it is one of the main locations required by the customers.

Germany, France, Belgium and the Netherlands were also used frequently, but beyond that there are only very general trends, with the Scandinavian countries mentioned least. The countries then used by the various banks are determined by the domicile of the bank, together with any partnerships to which they belong.

There seems to be no strong link between the size of a bank (and its perceived share of cross-border euro management) and the number of centres in which it provides its solution. Some of the major players provide their services from a relatively small number of locations, while others offer their services in nearly all of the EU countries. It is even possible to manage and concentrate euro balances outside of the EU, in Norway and Switzerland, which both have access to euro transfer networks.

The initial indications of the survey are that 21% of the banks are only targeting their service at multinational companies (with a turnover of $500m or more). A further 43% of the banks appear to be offering their solution to a wider group of companies on a selective basis, targeting companies in countries where they have the capability to deliver that service. However, the remaining 36% were keen to offer their solutions to companies, large and small, throughout the EU.

I will be presenting the results of the study at the UK Treasurers' Conference in Brighton on 30 April, and more detailed information will also be available on the ACT website **www.treasurers.org**.

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