The pros of pooling

HAVING THE RIGHT BANK ACCOUNT STRUCTURE IN PLACE COULD SAVE YOUR COMPANY MONEY AND MITIGATE RISKS. SARAH BOYCE EXPLAINS

Organisations change continuously. They may grow or contract, either domestically or internationally; their strategic plans will evolve or be completely transformed. Any cash management strategy needs to reflect the company's current strategic business plan. For example, it's unlikely to add value for shareholders if it has a business plan to sell products in Venezuela, but doesn't have a plan to get the cash out.

How the cash in the organisation is physically managed is one strand of the cash management strategy – it may seem unglamorous, but like many areas of cash management, setting up the optimal bank account structure for your business not only mitigates risks, but can actually save money for the organisation.

Every organisation needs to consider its bank account structures on a regular basis in order to ensure that those structures are still relevant for the business and are as efficient as possible. This article will look at cash management structures in the form of cash pools.

Why set up a cash pool?

You might find it is a good idea to set up a cash pool if you want to:

- Pay and/or receive foreign currency, whether with third parties or intercompany on a regular basis;
- Optimise liquidity management, both domestically and across currencies and borders;
- Centralise operations to take advantage of economies of scale, aggregating buying power and minimising treasury transaction costs;
- Obtain greater visibility of information for control and governance purposes; and
- Monitor and manage currency exposure.

Notional pooling, cash concentration or a hybrid?

There are two principle cash-pooling solutions that can be adopted by companies – notional pooling or cash concentration. Companies can also use a hybrid of both.

Deciding which one to use will depend on company-specific considerations:

- Legal structure of the company/participants.
  - > This may determine where to hold foreign currency accounts.
  - > The geographic location of companies will materially influence the sort of solution that can be implemented.
- Culture and degree of centralisation within the company.
  - > For example, highly autonomous subsidiaries may struggle culturally with their cash being swept out of their control, so notional pooling may be more appropriate.
- Tax, regulatory and legal considerations and constraints.
  - > Notional pooling is not permitted in some jurisdictions; concentration accounts are not allowed in others.
  - > Tax, particularly withholding tax (WHT), will be a major consideration when structuring a pool.

Notional pooling means companies can minimise their overdraft interest while retaining local autonomy. Bank account balances within a notional pool are offset against one another and interest is paid (or earned) on the net balance.

Cash concentration, on the other hand, allows central treasury to optimise the group's liquidity by physically centralising funds that can then be used either to fund other parts of the organisation or repay external debt.

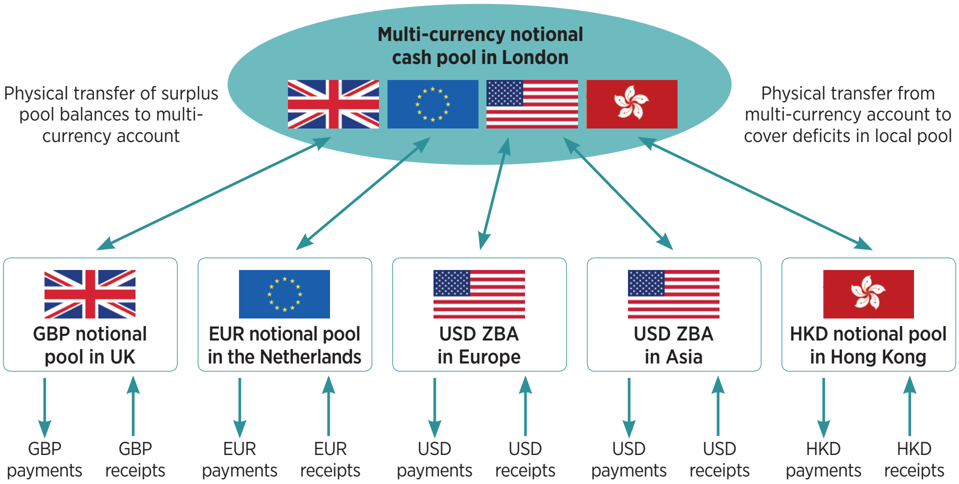
In either case, a pooling structure enables the company to fund the group centrally and is an efficient way of passing down funds to those parts of the organisation that need them.

In theory, notional pooling structures can either be single-currency or multi-currency, one-country or cross-border solutions. In practice, cross-border or multi-currency notional solutions are extremely complex to implement, both for the bank and the company, and are rarely seen. Notional pooling is regarded as a form of bank lending and, as a result, the notional pool-holding bank will require cross-guarantees in place for all pool participants and full legal right of set-off over the pool accounts, both for practical reasons and for those of capital adequacy – otherwise additional costs will be incurred by the bank.

Cash concentration is less complex than notional pooling in that a company physically sweeps funds from almost any bank in almost any location to a central account if local regulation allows. Many companies prefer to use cash concentration as it eliminates balances from the local accounts and provides maximum flexibility as to how surpluses are used, or how deficits are funded.

Cash concentration pools can also be structured to suit the specific requirements of the company. For example, they may be zero balance accounts (ZBAs), whereby the bank accounts are completely zeroed, or they could be set up so that sweeps occur only when target balances have been achieved (this reduces the number of transfers and associated costs, while ensuring that surplus funds are remitted to the centre). Movements

Example of a pragmatic account structure



in cash concentration structures are treated as intercompany lending for tax and regulatory purposes (notional pooling is treated as bank lending).

In countries that do not offer notional pooling services, such as the US, physical movement to a concentration account is the cash pooling solution that will be adopted. Also, for most cross-border situations, cash concentration has proved to be the most practical solution to date.

There are many ways of structuring accounts, with no single optimal structure. Due to regulatory and organisational issues, most companies will adopt variations on the standard structures described above and may use a combination of structures, depending on their own strategic, legal and tax considerations.

For example, in order to address both the needs of the local operating units and group treasury, many companies establish a pragmatic account structure using concentration in conjunction with notional pooling to allow autonomous local cash management with centralised control. (See the example of a pragmatic account structure, above right.)

This structure is based on a multi-currency notional pool account owned by treasury and held in a single, tax-efficient location (ideally where WHT is not deducted at source). It consolidates the positions (surpluses and deficits) in the in-country cash pools (both notional and cash concentration). Domestic banks are used to provide the local banking services needed by subsidiaries. Preferably, in-country accounts are notionally pooled, where available, with a treasury account in the pool. Then, on a periodic basis, treasury manages the liquidity between the pools through cross-border concentration (often regionally).

It is worth noting that a multi-currency cash pool is only really available to the largest, most powerful corporates, with the majority of companies manually managing a series of centralised currency accounts.

Finally, don't forget that the account structure a company selects will determine the type of bank it needs to support its cash management needs.

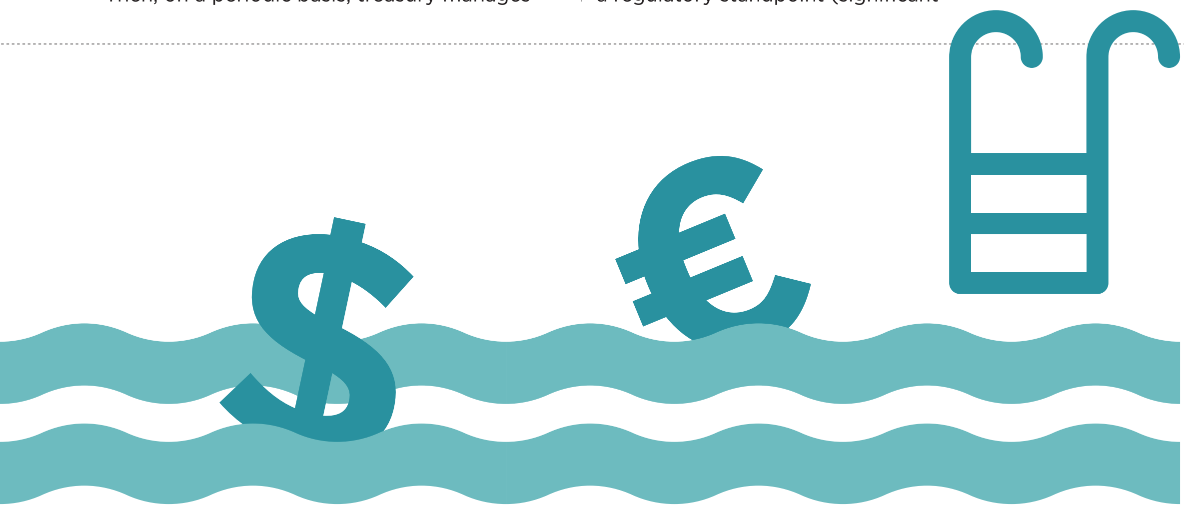
Conclusion

Account structures can be designed to suit the precise requirements of the company and the following have a huge impact on their design:

- Not everything is best done centrally (despite a tendency for treasuries to centralise).
- Not all countries are the same from a regulatory standpoint (significant differences can arise in tax, law and, particularly, exchange controls.
- Not all banking systems are the same.
- Not all subsidiaries have the same needs or level of financial expertise.
- Banking structures can be designed currency by currency, country by country or on a regional basis.

Companies with complex organisations need to beware of tax-inefficient banking structures. Local banking and tax regulations may also mean that local solutions cannot be combined or incorporated into cross-border solutions.

Each company needs to create an account structure that best meets its own unique set of requirements in the light of its strategic plan, treasury goals and corporate organisation. It also needs to regularly review its structures to ensure that they remain relevant.



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