EURO CASH POOLING

BRIAN WELCH, A MEMBER OF THE ACT'S TECHNICAL COMMITTEE AND EURO CASH WORKING GROUP, REVEALS WHAT THE LEADING BANKS ARE OFFERING CORPORATES IN THE EU.

Last year, the Technical Committee established a working group to investigate euro cash management to find out the different solutions being offered by the leading banks. At the outset, we identified that there were several issues which appeared to be preventing the timely and cost effective management of euro balances throughout the EU. Here are our findings:

- pooling, as we understand it in the UK, is not always available in individual countries in the EU and is even more difficult to achieve between the different countries in the EU;
- the solutions being offered by the banks differ widely; and
- there are other 'structural' issues, such as tax, legal issues and central bank reporting, that prevent conventional pooling.

BANKING IN THE EURO ZONE. Treasurers had expected that the introduction of the euro would result in the development of new cash management systems, which would mean lower levels of aggregate liquidity and more flexibility of cash movement between countries.

OUR DEFINITIONS

▪ NOTIONAL POOLING
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 or credited to a designated master or header account, but where the accounts are held in different countries, 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 or from a 'master' account to leave a zero balance or target (residual) balance at the operating accounts and an aggregated balance on the master account.

When the euro was being planned from the mid-1990s onwards, there was an expectation by businesses that one or two of the major domestic European banks might emerge as 'European champions' with a domestic capability in the major EU countries. With one or two exceptions, this has not happened. The closest we have come to this has been the emergence of banks with the direct ability to provide a full domestic service in five or six countries, with the rest of the EU being covered using partners, networks, alliances and bilateral arrangements.

In fact, there are very few banks that are able to provide banking coverage throughout all members of the EU that have adopted the euro (euro zone), and some of the best pan-European coverage is provided by the major US banks.

It needs to be emphasised that, while the euro is the same currency throughout the EU, it is also the domestic currency for each of the euro zone countries, and as such is subject to the different tax, law and domestic central banking regulations in each of those countries. This is best illustrated by the fact that to transfer a euro balance from one euro zone country to another, payments of up to €12,500 are treated as domestic transfers, but payments of more than €12,500, are regarded as international transfers at a higher price. From 1 January 2006, that limit will be raised to €50,000, but most corporate payments and cross-border transfers are unlikely to benefit, being much larger. If that improvement is an indication of the pace of progress, it will take a very long time for transfers of €10m to be charged at the domestic rates.

THE BANKS. The Euro Cash Working Group (ECWG) decided to base its survey on the leading banks, and took a great deal of care developing a questionnaire for that purpose.

Based on the knowledge of the members of the group, and the banks most frequently used by the members of the Association of Corporate Treasurers (ACT), the questionnaire was sent to:

- three US banks, providing services for multinational corporations throughout the EU;
- eight euro zone banks which had a reputation for or claimed expertise in euro cash management; and
- four UK banks with significant shares of the corporate banking market.

We promised confidentiality concerning the banks' solutions, because, at this stage, the various solutions are still specific to the individual banks – or at least the software developed for that purpose. Nevertheless, we were also asked by one of the banks to sign a confidentiality agreement, therefore we cannot disclose specific information about any of the banks.

There are two main solutions for managing euro balances, provided by the banks, namely notional pooling, and zero balancing.

NOTIONAL POOLING (*see box for definition*) is the preferred solution for companies so that combined value of their euro balances throughout the EU can be used. It maximises the interest earnings (or minimises the interest cost) and reduces the need to make cross-border euro payments.

ZERO BALANCE (OR TARGET BALANCE) SWEEPING (*see box for definition*) is used to transfer (sweep) 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 less efficient than notional pooling, depending on the cashflows of the company concerned.

OVERLAY STRUCTURE. This is a convenient technique that 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.

KEY ISSUES IDENTIFIED

The main points identified as follows:

QUESTION 1

What type of customers do the banks target?

- Multinational companies (and their subsidiaries only).
  20% – three banks.
- A wider group of companies on a selective basis, depending on the banks' location and capabilities.
  43%-47% – seven banks.
- All kinds of companies, large and small, throughout the EU.
  33% – five banks.

COMMENT. The banks being the most selective were not always the largest. The banks prepared to deal with all kinds of companies were not always the ones with the best expertise, but they did do everything they could to meet customers' requirements.

QUESTION 2

How do the banks support their customers in different countries?

- Most of the leading banks could support companies with a full 'domestic' capability in: Germany, France, Italy, Netherlands, Belgium, Spain, Ireland and the UK.
- Only one bank could provide a full domestic capability throughout the EU.
- Where the banks do not have a 'domestic' capability they use partners, networks, alliances and bilateral arrangements. These are most likely to be used in Austria, Finland, Sweden and Denmark.
- Luxembourg and Greece are places in the EU where several of the banks may be unable to provide support.
- The countries outside of the EU where the main banks are able to provide euro cash management facilities are Switzerland and Norway.
- Where there was a 'domestic' cash management capability, the banks could provide end of day and intra-day reports with balances moving with 'today's value'.
- Where the service is provided by a partner, the transfer date was more variable, but with auto concentration tending to move with today's value, and manual concentration generally moving today's end-of-day balance tomorrow.

COMMENT. Banks either offer a solution based on a sweep of balances to a single location, where balances are then pooled, or an overlay combined with the pooling of balances. The use of the overlay is a practical solution to the shortage of banks with a full domestic capability throughout the EU.

It satisfies local banks' concerns about insolvency, and the correct location of interest and its taxation, but in practice those local banks are worse off, because any surplus liquidity is transferred to the overlay provider.

QUESTION 3

What services are provided in which international concentration locations?

- London is the most frequently used concentration centre offered by the banks.
  87% – 13 banks.
- The majority of concentration by US and UK banks is handled in London because:
  - of a positive approach to fiscal, legal and regulatory issues;
  - access to excellent euro liquidity and payment networks;
  - most of the banks have major operations in London; and
  - it is one of the main locations required by the customers.
- There is no strong link between the size of a bank and the number of concentration centres offered.
- The US banks offer either a small (four to five) or medium (eight to nine) number of centres.
- The UK banks offer either a single location or a small range of centres.
- The EU euro zone banks range from a single/small number of locations to almost any of the countries (maximum offered 16 locations).
- The most frequently used centres:
  - London: 13 banks – both pooling and zero balancing account (ZBA).
  - Frankfurt: 11 banks – eight both, three ZBA only.
  - Paris: 10 banks – five both, five ZBA only.
  - Amsterdam: 11 banks – both.
  - Milan: eight banks – four both, four ZBA only.
  - Dublin: five banks – one both, four ZBA only.
  - Brussels: eight banks – both.
  - Madrid: seven banks – five both, two ZBA only.
  - Lisbon: four banks – three both, one ZBA only.

In this, the existing local bank is 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. It therefore enables companies to retain existing local country domestic relationships and is cost effective concerning transfer costs.

REVEALING RESULTS. The basic findings of the study are not the full story. It is important to emphasise that euro cash management is not a standard product. Although the ultimate method of delivery may use two or three techniques – zero balancing, notional pooling and overlay – the approach by each bank is different and it depends on the location and/or domicile of each bank. Some countries and the banks from those countries are more flexible in the interpretation of their own local regulations, taxation and legal requirements.

The solution offered by each bank will depend on its own infrastructure, partners and alliances. There are also a range of specific national issues which include:

- France: interest cannot be earned on current accounts and is therefore achieved using the SICAV.
- Denmark, Portugal and Austria: stamp duty is charged on overdraft facilities.
- Spain and Portugal: insolvency issues.

CHARGES AND COSTS. As each bank's approach is different, their charges are different. For pooling (and interest enhancement) there will probably be a charge based on the bank's cost of capital, charged as a monthly fee.

For zero balancing and concentration accounts there will probably be a monthly fee which will reflect the cost of cross-border transfers, how the system is managed (automatic or manual), the number of transfers each month and the number of countries involved.

A GUIDE TO THE FUTURE. If you cast an eye back to the October 2002 issue of *The Treasurer*, Bob Lyddon, one of the members of the ECWG, provided a useful template for companies to assess whether euro cash management could prove beneficial for corporates, and that guide is just as valid today.

My thanks to all members of the group who contributed to this project.

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