Centralising European cash management

A recent report from the Dutch Association of Corporate Treasurers provides an insight into products and services on offer, as consultant Joost Bergen explains.

The Dutch Association of Corporate Treasurers' (DACT) working group on European cash management commissioned a report to provide DACT members with a better understanding of recent developments in pan-European cash management. The report was presented on 29 April 1999 and is summarised here.

The report is divided into three parts: a theoretical framework, including new trends in cash management and how to move towards a European cash management approach, information on regulatory issues, central bank requirements, tax and legal issues (both provided by members of the working group) and finally the results of a bank survey.

Moving towards European cash management

The arrival of the euro has shifted the emphasis in many European treasury departments from foreign exchange management to cash management and has triggered discussions on further centralisation of cash management. In most European corporations, cash management functions have been decentralised at a national or regional level or per currency. Setting up a pan-European cash management structure requires significant development in a company's cash management organisation. The three main considerations are:

- whether to centralise or decentralise. With a central approach, the question arises which tasks will be executed in-house and which tasks can be outsourced, allowing treasury staff additional time for more intense treasury operations like exposure management, risk management and funding;
- pooling techniques. These can be either zero balancing or notional pooling. In the case of zero balancing, the cash of all the operating companies could be concentrated at one location (for example in liquidity funds) or country by country. Since cash pooling is subject to several regulatory restrictions it is very important to choose the right (combination of) pooling techniques that are valid in all concerned countries. Currently zero balancing seems to be less affected by regulations than notional pooling (see *Figure 1*); and
- bank selection. Which banks and how many will be selected for the cash management and account structure and can these banks provide a total range of cash management products against acceptable costs? A complicating factor is that each bank offers its own cash pooling products with their specific advantages and disadvantages.

Regulatory issues

Significant differences still remain in euro-land, despite the introduction of the euro. Local regulations restrict a company's options for cash pooling and restrict banks in their support of such cash pools. The types of restrictions to consider are:

- central bank requirements (eg solvency and liquidity requirements, central bank reporting for resident/non-resident accounts);
- tax regulations (eg arm's length directive, rules on deductibility of interest, withholding tax, stamp duties, thin capitalisation rules); and
- legal issues (eg conditions for notional pooling, restrictions on zero balancing and group requirements).

> **DACT bank survey**
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> The bank survey was carried out in December 1998 and updated in March 1999. Banks were selected on the basis of their position in the Benelux area or because of their reputation as providers of international cash management services.
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> The information given in the survey was supplied by the respective banks. Readers should be aware that there may have been developments since the report was published and that all information should be confirmed with the relevant supplier/provider. ■

Products and services on offer

There then remains the practical issue of deciding which bank(s) to involve in implementing your preferred cash management structure. This often proves to be rather difficult and time-consuming for the individual company.

The DACT bank survey aimed to determine which cash management products and related services banks are actually able to offer to large corporate clients.

The following banks took part in the survey: ABN Amro, BankAmerica, Bank Mendes Gans, BNP, Chase, Citibank, Deutsche Bank, HSBC, ING, KBC Bank, and Rabobank International.

To keep the questionnaire as concise as possible, the survey focused on three key areas in assessing the cash management capabilities of banks:

- cash pooling products;
- domestic and cross-border payments; and
- electronic banking tools.

FIGURE 1 Legal possibilities for domestic zero balancing and notional pooling per country

Country	Legal possibilities
Belgium:	Interest compensation is only allowed within the same legal entity. In case of notional pooling credit requirements may be necessary.
France:	No credit interest will be paid on resident accounts. For setting up a cash pool there are group treasury requirements and an agreement among treasury participants. There are possibilities for notional pooling with French banks.
Germany:	Notional pooling is possible in theory but not practicable in reality. Shadow administration is necessary.
Austria:	Notional pooling is possible but dependent on very strict legal regulations and bankruptcy laws. Zero balancing may be subjected to stamp duties.
Italy:	Banks may not be allowed to offset reserves. Zero balancing can be set up making use of the tax treaties Italy has with other countries.
Spain:	For interest compensation there are very strict fiscal rules such as, reporting to the same tax authority.
Portugal:	Withholding tax issues make interest compensation unattractive to clients. Zero balancing is possible but is subjected to stamp taxes.
Finland:	Zero balancing is subjected to stamp duties (1.5%).
Ireland:	There are strict group requirements for setting up a cash pool.
Denmark:	Danish corporates are not allowed to lend money to a foreign parent company.

Cash pooling products – Three types of cash pooling products were defined:

- notional pooling (or interest compensation);
- zero balancing (or cash concentration); and
- overnight zero balancing (a form of zero-balancing whereby the original individual account balances are restored the following day).

To gain a better understanding of the specifics of the pooling products offered by the respondents, we further distinguished between domestic and cross-border pooling, and between single and multi-currency pooling. In the case of zero-balancing, we also asked the banks to indicate whether only individual credit balances can be swept to a master account, or whether it is also possible automatically to fill up debit balances from the master account.

The results show a rather mixed view. The good news is that in every Emu-country it should be possible to create a cash pool in one form or another. The bad news is that hardly any of the respondents seems to be able to provide both notional pooling and zero-balancing in all Emu-countries. Not surprisingly, most banks have problems offering notional pooling structures. Some banks do not offer notional pooling at all, whilst others can offer it in some countries or in a limited form.

However with most respondents, single-currency domestic zero-balancing is available in most Emu-countries; in many cases even multi-currency and cross-border. Overnight zero-balancing though, is only possible with less than half of the banks.

Domestic and cross-border payment capabilities – A key factor in setting up a pan-European cash management structure is that a company's cash management bank(s) is able to handle both cash management and operational payments, so we asked the respondents whether they have access to the various high value and low value clearing systems in the respective Emu-countries and what cut-off times they maintain for domestic and cross-border payments.

With only a few exceptions, most respondents have direct access to the high value euro-clearing systems TARGET and EBA (see *Figure 2*) and to the local high value and low value clearing systems in nearly every Emu-country. With respect to the cut-off times, the outcome is quite remarkable. While within almost all banks the cut-off times applied for domestic and cross-border transfers are the same and are applicable throughout the Emu-countries, the variety between banks with respect to cut-off times is greater than one would expect. Some banks already close their systems for payments at 14:00 hrs, others not before 16:15 hrs. Occasionally a deadline of 11:30 hrs applies.

Electronic banking products – The third important factor in assessing your bank's cash management capabilities is the availability of electronic banking tools. We asked the respondents to indicate whether their electronic banking products enable clients to initiate payments centrally and receive account information from all their domestic and foreign bank accounts.

All respondent banks indicated that they have electronic banking tools to issue payments centrally from accounts with their own subsidiaries or branches, and usually also from accounts with partner banks. Nearly all electronic banking products also allow for making payments from third-bank accounts.

In most cases, it is also possible to receive balance and transaction information electronically, at least end-of-day information. Receiving intra-day balance and transaction information is sometimes not possible.

Survey conclusion

Although it is rather difficult to draw overall clear-cut conclusions, it is probably safe to conclude that there are very few banks which can provide all cash pooling products everywhere in Europe. Interestingly enough, among them are two non-European banks. It is also clear that most banks have access to the relevant clearing systems and it looks like they have the electronic banking products available to support the running of a pan-European cash management structure. Until cash pooling products have further developed and are available in all Emu-countries, adopting a pan-European cash management approach will probably mean combining cash pooling techniques and using more than one bank.

General conclusions

The introduction of the euro will lead to a further centralisation of the cash management activities of many European companies. The development in information and communications technology is an important driver for this centralisation. Taking the advantages of cash pooling in general into account, these advantages will be even greater when cash pooling is carried out on a pan-European scale, thus increasing the value of centralised cash management even further.

An important obstacle is still to be found in many legal, fiscal or monetary regulations limiting cash pooling in some countries. For this reason, the specific cash pool structure for a company depends on the countries to be included in the cash pool. The regulations may be harmonised in the future but there are no clear indications of this yet. For the time being, zero-balancing is the most appropriate method of setting up a pan-European cash pool.

The cash management products offered vary from bank to bank. This is caused by regulatory issues, but also by organisational, technical and legal differences between banks. Since one bank offers better services in a country than another, using more than one bank for European cash management may be a good solution, especially when third-bank payment initiation makes multi-bank zero-balancing possible. This could be an important development in the near future.

Taking the above into account it may be wise not to bet on one bank for your euro cash management yet but to create a flexible cash management structure and frequently review the cash management possibilities of the banks so that changes can still be made. The number of banks you need will (amongst others) depends on the countries involved.

Because of the new-born state of euro cash management, the products offered are still very heterogeneous and fully under development. Until cash pooling products have further developed and are available in all Emu-countries, pan-European cash management will probably mean having to combine cash pooling techniques and using more than one bank. ■

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Members of the ACT can order the DACT report at a cost of €40 from the DACT on +31-40-242 1744 (the price includes postage).

FIGURE 2 Cash management checklist

This checklist provides a selection of points for a company wishing to review its cash management function.

Internal factors

Cash management

- ❑ How many domestic transactions (deals)?
- ❑ How many cross-border transactions (deals)?
- ❑ What kind of deals?
- ❑ Kind of payment instruments?
- ❑ What particular local services will we need?
- ❑ Interest and currency volatility and exposures?
- ❑ Instrument used for cash collection (real cash/giro money)?
- ❑ How can we come to same-day real time information?
- ❑ How can we use electronic banking?
- ❑ What tasks can we outsource to banks?
- ❑ How can we reduce European working capital levels?
- ❑ How can we minimise the cross-border and domestic transaction costs?

External factors

Governmental

- ❑ Local legislation and monetary regulations
- ❑ Tax rules
- ❑ Supply of banking products
- ❑ Supply of IT-services

Banks

- ❑ Which banks offer local payment instruments, without losing value days, which match companies' local cash management criteria?
- ❑ Which banks are able to offer a pan-European cash management structure or solution?
- ❑ Should we use one bank or a combination of banks with an overlay bank structure?
- ❑ What means do banks provide for creating cash-forecasts on a daily and longer term basis (eg can they provide intra-day real time information on a local or on a European level?)

General issues

Apart from the specific factors dealt with above, a number of general business characteristics could influence the optimal pan-European cash management solution:

- ❑ What is the current organisation structure, corporate business and treasury/cash management?
- ❑ What are the existing internal and external netting possibilities?
- ❑ What is the current policy of the treasury? (cost or profit centre)
- ❑ What is the geographic diversity of the corporate?
- ❑ How is the geographical distribution of production and sales?
- ❑ Type of industry: mass production, project oriented or trade company?
- ❑ What particular local services are needed for specific units and countries?
- ❑ Vertical system integration: system integration between banks and corporations
- ❑ Horizontal system/process integration: the integration with other businesses (customers and suppliers)
- ❑ What type of clients does the company have? (retail, business to business, affiliate transactions only)
- ❑ Is the business driven by a number of cash transactions or does the business deal solely with electronic payments?
- ❑ Are there units/countries that are typical cash cows or cash bleeders?
- ❑ Is the business financially harmonised on a European level or are there local finance organisations?
- ❑ What is/are the functional currency/currencies?
- ❑ What are the risks of leaving cash in certain countries? ■