6.3.4 Cash Management

Exercise Answer

Unit: Unit 2 – Treasury Applications

Module: Module 6 – Managing the corporate structure

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Summary: Answer to exercise in cash management in a multinational.

Keywords: parent, holding company, operating subsidiaries, royalties, license, multi-lateral netting, foreign exchange, intercompany loans, cash management, pool, control account, local currency, MT103, Sarbanes-Oxley, syndicate, ancillary business, overlay, SWIFT, double tax treaty, withholding tax

This response contains answers to Task 1 (country presences of the group's existing banks) and Task 2 (SWIFT SCORE-Ready banks in the countries of the acquisition target's subsidiaries).

Then it gives specimen answers to the four questions.

It also gives the reasoning behind the answer in some detail in two cases:

1. What do you think about options like SWIFT for Corporates and Overlay
2. What Cash Management structure the group would adopt.

Task 1 Answer

✓ or ✗ means presence or no presence
✓ means Top-10 bank in the country according to http://www.relbanks.com or Wiki where there is no relbanks listing

Country	Barclays	ING	SocGen	Danske	Lloyds	TorDom	BofA
Brazil	✓	✓	✓	✗	✗	✗	✓
Chile	✗	✗	✓	✗	✗	✗	✓
Mexico	✓	✓	✓	✗	✗	✗	✓
Uruguay	✗	✗	✓	✗	✗	✗	✗
Poland	✗	✓	✓	✓	✗	✗	✗
Czech Republic	✗	✓	✓	✗	✗	✗	✗
Slovakia	✗	✓	✓	✗	✗	✗	✗
Hungary	✗	✓	✓	✗	✗	✗	✗
Romania	✗	✓	✓	✗	✗	✗	✗
Bulgaria	✗	✓	✓	✗	✗	✗	✗
Singapore	✓	✓	✓	✗	✗	✗	✓
Hong Kong	✓	✓	✗	✗	✗	✗	✓
Thailand	✗	✓	✗	✗	✗	✗	✓
Malaysia	✓	✓	✗	✗	✗	✗	✓
Australia	✓	✓	✓	✗	✗	✗	✓
New Zealand	✗	✗	✗	✗	✗	✗	✗
Vietnam	✗	✗	✓	✗	✗	✗	✗
Cambodia	✗	✗	✗	✗	✗	✗	✗

Websites[1] used to access data:
http://group.barclays.com/about-barclays/about-us#barclays-around-the-world
http://www.ing.com/Our-Products-Services/Products-Services.htm?countrycode=[ ]
is the Australian presence just the ING Direct Savings operation, which in UK, Canada and US is being sold off?

https://entreprises.societegenerale.fr/dossiers/international/passeport
http://www.societegenerale.com/nos-metiers/carte-dimplantation

http://www.danskebank.com/en-uk/Pages/default.aspx - panel on right: Find us internationally
www.lloydstsb.com
http://www.td.com/about-tdbfg/our-business/index.jsp
http://www.bankofamerica.co.uk/about-bank-of-america/organisation-profile/ - right-hand panel "Global Reach"

[1] Websites addressed in 2013

Task 2 Answer

Insert the names of the banks who are certified as “SWIFT-Ready”, eliminating the ones you would not be prepared to deal with.

Country	Banks
Brazil	Citi, JPMorgan
Chile	Citi, Bank of Tokyo-Mitsubishi (BoTM)
Mexico	Citi, JPMorgan, BofA, BBVA, RBS
Uruguay	Citi
Poland	Citi, JPMorgan, BoTM, **BofA**, RBS, BNP, Danske, Deutsche, HSBC, SocGen,
Czech Republic	Citi, JPMorgan, BoTM, **BofA**, RBS, BNP, Deutsche, HSBC, SocGen, Unicredit
Slovakia	Citi, JPMorgan, **BofA**, RBS, KBC, HSBC, Unicredit
Hungary	Citi, JPMorgan, **BofA**, BNP, Deutsche, Unicredit
Romania	Citi, JPMorgan, RBS, BNP, SocGen, Unicredit
Bulgaria	Citi, BNP, SocGen, Unicredit
Singapore	Citi, JPMorgan, BoTM, BofA, RBS, BNP, Deutsche, HSBC, Credit Agricole, SocGen, StanChart, Sumitomo
Hong Kong	Citi, JPMorgan, BoTM, BofA, RBS, BNP, Deutsche, HSBC, Credit Agricole, StanChart, Sumitomo
Thailand	Citi, JPMorgan, BoTM, BofA, RBS, Bangkok Bank, Deutsche, HSBC, StanChart, Sumitomo
Malaysia	Citi, JPMorgan, BoTM, BofA, RBS, Malayan Banking Berhad, Deutsche, HSBC, StanChart, Sumitomo
Australia	Citi, JPMorgan, BoTM, BofA, RBS, ANZ, Westpac, HSBC, Sumitomo
New Zealand	Citi, JPMorgan, BoTM, ANZ, HSBC,
Vietnam	Citi, JPMorgan, BoTM, Deutsche, HSBC, StanChart, Sumitomo
Cambodia	--

BofA – according to their own website, BofA have no presence in these countries, so how can they offer SWIFT Corporate Access there?

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Answers to 4 questions

Your objectives are:

- Visibility of all cash
- Sarbanes-Oxley compliance
- Increase cash held in the Finance BV for making available to the Holding BV to meet its debt payments to the Capital BV ~ and so on to the banks
- Reward the banks that put up the debt with the ancillary business

Answer 1
What would you do to increase cashflow?

1. Ensure all the companies of the new group join the Multilateral Netting unless regulation forbids it, and the payments terms are 30 days. The Netting Centre is the Dutch Finance BV
2. Make full use of leading for intercompany invoices payable by countries where cash appears to be building up, and lagging where it is falling
3. Change the royalty arrangement between the Netherlands Holding Company and all other group companies where there is a Double Tax Treaty with the Netherlands:
    a) Introduce/increase the royalty fee for the subsidiary to be allowed to market the group's licences;
    b) Increase the royalty fee per licence sold up to the limits acceptable under Transfer Pricing
4. Go through each of the countries without a Double Tax Treaty with the Netherlands (Brazil, Chile, Mexico, India, Thailand, Malaysia, Vietnam, Cambodia) and examine:
    a) What countries they do have a DTA with that in turn have a DTA with the Netherlands;
    b) What the rates of deduction are for royalties;
    c) Whether the subsidiaries in these countries could be made intermediaries for the licencing into the non-DTA countries;
    d) What is the tolerance for a commercial increase in licence fees such that, after all the deductions and the amounts that cannot be recovered, there is still a group benefit in extracting royalties from that country?
5. Run down short-term loans where there is cash in the same country: that is just wasteful. Only the Dutch Finance BV, the UK parent and the US company should have any short-term loans – and even they can be run down if cashflow can be increased, with the Dutch Finance BV being the final point of borrowing
6. Reduce the balances held at a subsidiary level to one week's outgoings as a maximum: even within the existing group pre-acquisition there was approx. US$500 mil of Cash in subsidiaries where there were no regulatory barriers to the cash being funnelled up to the Netherlands (excluding $897 mil in the US subsidiary)

Answer 2
How would you view the usage of:

- **SWIFT Corporate Access**
- **An Overlay Bank?**
- **Your own pre-existing banks?**
- **The acquired group's local banks?**

General
The networks of the banks that have supported our company up to now and in financing the acquisition represent a poor overlap with the acquired group, in terms of:

- Country coverage
- Depth of services within the countries: only in a few cases does the local presence of our major banks feature high up in a ranking of local banks

This is a serious issue:

- How do we come good on our promise to reward their support with ancillary revenues, when these banks cannot provide the respective ancillary services?
- How do we ensure the day-to-day needs of subsidiaries are catered for?

The ancillary business consideration rules out-of-court solutions such as:

- Using one Overlay Bank on a global basis
- Inserting a bank like Bank Mendes Gans for a global, cross-currency notional pool

The lending banks simply would not accept so much business being carved out and awarded to a bank that is not in the lending syndicate.

With that in mind the solution has to be based around using our Dutch Finance BV to borrow and lend with the subsidiaries as intercompany loans, rather than using a bank to intermediate that. There is no one bank that we would be able to use that is capable of intermediating that advantageously.

There are certainly general advantages to having a bank interpose itself (fewer Thin Capitalisation issues, generally easier deductibility of debit interest, lower withholding tax rates) but these are not available to us in a practical way. Instead, our Dutch Finance BV gives us access to the network of Double Tax Treaties that the Netherlands has. "Key Facts per country" shows that the rates of withholding tax that would be levied (if any) under those treaties on intercompany business. These rates are not so high compared to the Dutch corporation tax rate as to cause substantial withholding tax to be paid away and not recovered. As a result the opportunity cost deriving from not completely optimising Cash Management should be acceptable.

The big show-stopper in “Key Facts per country” is the exchange control in Brazil, given that $1,120 mil of cash are tied up there. Brazil needs an approach of its own using measures to increase royalties and find an intermediary country that it does have a Double Tax Treaty with.

Sarbanes-Oxley compliance then needs to be based around the usage of the Dutch Finance BV and:

- Use of Multilateral Netting
- Reducing the number of banks
- Using just one bank per country where possible
- Combining accounts at that bank locally using ZBA or Notional Pooling, with the header account/pool control account belonging to the Dutch Finance BV where possible
- Taking electronic reporting on the header account/pool control account at that bank
- Eliminating simultaneous credit balances and short-term loans in each subsidiary
- Having a quick and cost-effective conduit for movement of funds into and out of each header account/pool control account, back to one of the main banks (Barclays, SocGen, ING)

This is not a degree of compliance that is as watertight as others but those others simply are not feasible for this company at this time.

SWIFT Corporate Access

There is a major mismatch between:

- The banks certified as SCORE-Ready
- Our own banks
- The banks being used by the target’s subsidiaries

The only bank that features prominently as SCORE-Ready is Citibank, and since the target is using them anyway, through Citi’s own ebanking, it would be of marginal benefit – or perhaps of no benefit – to access Citi in those countries through a different channel.

The kind of banks that appear to be players in SCORE are ones that might act as Overlay Banks but not as main Payments+Collections banks in the countries concerned. There are exceptions to that rule of course, but not exceptions that are terribly relevant to our company’s situation (e.g. Westpac in Australia).

The SCORE-Ready certification is for a modest list of capabilities, but perhaps even they go beyond our initial needs, which are for visibility. That would be furnished by MT942 and/or MT940. The relevance of MT101 to a country like Brazil – which has strong exchange control – would simply be for local payments, which we do not want to initiate from offshore.

So it is possible that the level of the SCORE-Ready certification exceeds what we need in the first instance and that the banks that we and the target are using could meet our needs, through SWIFT, through an aggregator or whatever, but that does not come through from SWIFT’s information. SWIFT Corporate Access does not then appear to have great

attractions from what is presented by SWIFT itself – and the choice of a non-bank channel would for sure not greatly please our lending banks.

An Overlay Bank
Only two banks would come into contention for this:

1. Citibank, the target's main bank
2. Bank of America

We should be concerned that BofA may be able to do little more than act as Overlay (i.e. it may not add value compared to a local bank acting as both Over- and Underlay), and that its presence in Central & Eastern Europe is ambiguous (it is SCORE-Ready according to SWIFT but has no presence according to the bank's own website).

Lastly we would be allocating too much of the ancillary business to a bank in the Tier 2 of the lending syndicate if we appointed BofA as the Overlay. So our approach would only be to have an Overlay in place if there were unacceptable costs and delays in getting money to move between the Dutch Finance BV and the accounts of the subsidiary at its local bank.

Your own pre-existing banks
They really cannot do much, can they? Several really have no relevant presences beyond where they are already helping us (Lloyds, Danske, TorDom).

Barclays' coverage in Hong Kong, Malaysia and Australia does not at first glance appear to be of a calibre to merit displacing the banks the target was using.

Only the presences in Central & Eastern Europe of ING and SocGen seem to be of that calibre, since they have acquired significant local banks.

The acquired group's local banks
These are sizeable and reputable banks; many are subsidiaries or affiliates of banks like UniCredit, KBC and Santander: surely they can all produce MT940 to a reasonable standard, and operate MT101 where there are not regulatory barriers?

UniCredit and KBC are being used where potentially SocGen and ING can do it, but not Santander: we may well try to retain them particularly in LatAm. Maybe they can do Uruguay as well.

Answer 3
What is your structure for International Cash Management going forward and why? What will be the residual problems?

More to the point, what happens on Day 1?

The obvious, easiest and therefore most beneficial thing to do would be to get a log-in to the Citibank ebanking under the profile of the target, such that the Group Treasury can now view and operate all the Citibank-held accounts of the target.

The second action would be to set up MT940 reporting, if it did not exist already, on the other local accounts held by the target's subsidiaries, and to do that through Citibank's ebanking:

- One could do this through Barclays, SocGen etc and giving it to Citi might look like awarding them ancillary business when they are not a lender
- However through the Citibank ebanking you would get a complete country view:
    - Citibank local accounts
    - local accounts at other banks in the same country
- You would also get the ability to send local payments from Citi to the other banks
- The missing link would be to draw money out of the local banks into Citi

Group Treasury adds one more ebanking systems to its range but it should be possible to achieve one of the ways of increasing cashflow fairly directly - reducing the balances held at a subsidiary level to one week's outgoings as a maximum.

The other actions for increasing cashflow should also show more cash flowing into the Netherlands:

- Increasing royalty payments, settled in the Netting with commercial payments
- Cash-rich subsidiaries paying intercompany items quicker

Then what about the longer term?

There looks to be a strong case for upgrading the Dutch Finance BV from, essentially, a conduit company into a Treasury Centre.

In due course the place where the group owns its software licences may change, and the route through which the royalties on these licences are collected may change, but the Netherlands' network of Double Tax Treaties coupled with the position of the Dutch Holding BV are likely to perpetuate the significance of the Netherlands in the group structure.

The role of the Dutch Finance BV would be:

- Netting Centre
- Counterparty of the subsidiaries for FX, deposits and loans
- Holder of the control account in pooling arrangements established in each country, whether those arrangements operate through ZBA or Notional Pooling

The efficacy of this last role depends on the group being able to establish just one bank relationship in each country or at worst two:

- One for the day-to-day needs in-country
- One to act as a conduit for movements of money into and out of the country, without lifting fees or less of value – i.e. an Overlay

Based on available information and on the inferences to be drawn from the parentage of banks used by the target, a solution that should be workable and which should meet the ancillary business agreements with some of the banks would be to use the following banks.

Country	Day-to-day bank(s)	Overlay Bank (if any)
UK	Barclays, Lloyds	--
Netherlands	ING	--
France	SocGen	--
Denmark	Danske	--
Sweden	Danske	--
Finland	Danske	--
Estonia	Danske	--
Latvia	Danske	--
USA	BofA	--
Brazil	Banco Real	BofA
Chile	Santander	BofA
Mexico	Bancomer	BofA
Uruguay	Citibank (or Santander?)	--
Poland	ING	--
Czech Republic	SocGen	--
Slovakia	ING	--
Hungary	K+H Bank	--
Romania	SocGen	--
Bulgaria	ING	--
India	ANZ-Grindlays	Citibank
Singapore	United Overseas Bank	BofA
Hong Kong	Bank of East Asia	BofA
Thailand	Bangkok Bank	BofA
Malaysia	Malayan Banking Berhad	BofA
Australia	ANZ	--
New Zealand	ANZ	--
Vietnam	Vietnam Bank for Industry and Trade	Citibank
Cambodia	ANZ Royal Bank	--

Barclays, Danske and Lloyds are promised a shot at all the FX, loan and deposit business that the Treasury Centre has.

SocGen, ING, and BofA get more operating business where they are set up to do it: unfortunately for them, SocGen and ING overlap. BofA appears to come out the best – because they have the network – but what business will really flow through the overlay if the local banks are cooperative about connecting with the Dutch Finance BV?

This picture will also be sub-optimal and will have certain issues attached to it:

- Will Citibank fold their tents when asked just to be the bank in Uruguay and act as Overlay in a couple of places where BofA cannot do it? That won't give Citibank much residual revenue and they aren't a charity
- How efficiently and at what cost will it be possible to extract cash from and insert it into the Asia/Pacific countries, with Overlay and without it?

The inference is that each subsidiary sends money either directly from their local bank, or via the Overlay, to accounts owned by the Treasury Centre that are held either:

- At ING in the Netherlands

- At Barclays in the UK
- At SocGen in Paris
- At a hub of the Overlay bank – e.g. BofA London

The efficacy of that depends on the same arrangements as exist now between Barclays and Danske, SocGen and ING: MT103 payments with INTC code in Field 23e, to fit in with an agreement that intercompany payments within this network would be handled quickly and at low cost.

Those arrangements need to be expanded to include all the banks on the list. Unfortunately this arrangement – supported also by the sending of MT940 – is the low common denominators of International Cash Management. They are common arrangements precisely because of the situation this company is in: Cash Management counts as ancillary business and has been promised to a lending syndicate.

There is no free choice of banks. However the lack of presence and capabilities of banks rules them out of much of the business. The template for the solution has to allocate business to lending banks where they can do it, and then fit them into a Cash Management solution that will be sub-optimal for the company while still meeting most of the company's objectives.

The opportunity cost – the difference between the result of optimal Cash Management and what this company will achieve – is the price of borrowing from banks that do not have wider ICM capabilities.

At least the solution only involves the addition of one or two ebanking systems at Group Treasury:

- Citibank's on Day 1 – which may be temporary
- BofA's

The existing ebanking channels to Barclays, Lloyds, SocGen, ING and Danske remain in place. At a point where the target's local banks are taken out of the picture, the MT940 reporting should be done from the new bank into Barclays instead of Citi, where the new bank is not part of SocGen or ING.

If the local bank is not changing, the MT940 reporting should be switched from using Citi as a conduit to using Barclays at the point where Citi cease to act as the Overlay in that country.

At the end of the switchover Group Treasury would be getting reporting on the accounts as follows (nb access to any Overlay Bank is always through its own ebanking channel):

Country	Local bank	Ebanking channel	Overlay Bank and channel
UK	Barclays, Lloyds	Barclays, Lloyds	--
Netherlands	ING	ING	--
France	SocGen	SocGen	--
Denmark	Danske	Danske	--
Sweden	Danske	Danske	--
Finland	Danske	Danske	--
Estonia	Danske	Danske	--
Latvia	Danske	Danske	--
USA	BofA	BofA	--
Brazil	Banco Real	Barclays	BofA
Chile	Santander	Barclays	BofA
Mexico	Bancomer	Barclays	BofA
Uruguay	Citibank (or Santander?)	Barclays	--
Poland	ING	ING	--
Czech Republic	SocGen	SocGen	--
Slovakia	ING	ING	--
Hungary	K+H Bank	Barclays	--
Romania	SocGen	SocGen	--
Bulgaria	ING	ING	--
India	ANZ-Grindlays	Barclays	Citibank
Singapore	United Overseas Bank	Barclays	BofA
Hong Kong	Bank of East Asia	Barclays	BofA
Thailand	Bangkok Bank	Barclays	BofA
Malaysia	Malayan Banking Berhad	Barclays	BofA
Australia	ANZ	Barclays	--
New Zealand	ANZ	Barclays	--
Vietnam	Vietnam Bank for Industry and Trade	Barclays	Citibank
Cambodia	ANZ Royal Bank	Barclays	--

This is not too bad a situation, all other things being considered.

Answer 4
What might you have to ask other departments in your company to do to help?

The commercial department:

1. introduce/increase royalty levels;
2. make the royalty flows (who licences to whom) follow the structure of Double Tax Treaties;
3. load up the intercompany pricing on any goods supplied from the centre to subsidiaries: these should not be subject to withholding tax at all, and can be settled within a month via the Netting

Accounts Payable and Receivable – compel participation in Multilateral Netting