International Cash Pooling

Cross-border Cash Management Systems and Intra-group Financing

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1. International Cash Pooling

Globalization became a natural part of the world’s vocabulary. It is also well known that companies and corporate groups need to manage their cash flow. Out of these two common facts results something that is really worth looking at: international cash pooling.

The task of a Chief Financial Officer (CFO) in a company or corporate group is to manage financial risks and to optimise the financial situation of the company or the group. This optimisation is done in multinational corporations by cash management systems and in particular by way of implementation of cross-border or multijurisdictional international cash pools. Nonetheless, international cash pooling is a topic rarely reviewed. In practise it is however wide spread as it is practiced by corporate groups all around the world.

While setting up an international cash pool in a multinational corporate group it is crucial to take all involved jurisdiction into account. For example, the legitimacy of necessary up- and downstream loans within a cash pool needs to be assessed as well as questions of capital maintenance or a potential liability for losses, just to name some of the many questions arising when setting up a multijurisdictional cash pool. Cash pool systems therefore need to respect possibilities and barriers of company law, insolvency law and banking law. In addition an optimised cash pool must also take tax law requirements into account. The latter angle is not part of this book.

This book provides an overview of the legal requirements in 15 different countries when installing a cash pool system. It enables the reader to get an idea of the chances and risks which will accompany a multijurisdictional cash pool system involving the jurisdictions of his choice. It draws his attention to crucial requirements, provisions and issues, which are most important to deal with in the chosen configuration.
1.1 Cash management systems

The term cash management systems describes different systems of financing in companies and corporate groups. Although the term seems to be very broad, it really covers only two models for liquidity optimisation. These two models are cash pooling and netting. Cash pooling concentrates the whole liquidity of the corporate group on a single bank account (physical cash pooling) while netting describes the periodical settlement of all claims and debts between the companies of the corporate group.

Due to the international nature of today’s business and the international structure of corporate groups, parent companies and subsidiaries from all around the world are involved in cash management systems. From a technical point of view, cash management systems involving companies from different countries are easily practicable by way of electronic banking. Even different currencies can be handled: they can be pooled separately or may even be converted into one corporate currency within a multicurrency cash pooling system.

Apart from cash pooling there is one main different cash management system: so called netting, a process to settle the existing claims and debts between the companies in a corporate group. Netting gives the parent company of the corporate group an insight on supply relationships and other important information of transactions within the group. It also helps to reduce the costs for bank transactions. However, this book covers only cash pooling.

1.2 Different types of cash pooling

The different types of cash pools which are applied in practice are multifold. A first distinction must be made between physical and virtual (notional) cash pooling.

The main goal of virtual cash pooling is to optimise the interest rates which different companies within one corporation need to pay or may earn for their funds on their respective bank accounts. In case of virtual or notional cash pooling an actual transfer of cash does not take place. The funds (credit or debit) on the accounts of the virtual cash pool members are not transferred or balanced and remain untouched. The interest rate for the funds is however calculated on the notionally netted balance of all participating sub accounts.
1. International Cash Pooling

In contrast, in case of a physical cash pool, the funds on the bank accounts of all participating cash pool members are transferred to one master account which is usually held by the parent company of a corporate group or a specially set up separate (holding) company.

As a basic example for physical cash pooling the so called zero-balancing shall be explained.

In a zero-balancing cash pool all subsidiaries transfer their entire surplus cash on a regular basis (e.g. every day at midnight) to a master bank account of the parent company. The parent company in return transfers cash to all the subsidiary companies whose (slave) accounts have a debit in order to balance them out. The following picture shall visualise this basic cash pool system:

It is also possible to only transfer cash from the subsidiary companies, if their balance exceeds a set amount and just transfer money to the subsidiary companies, if their balance undercuts this set amount. Such a system is called target-balancing.

Another possible cash pool system is the so called on-line customer-initiated account transfer system. Authorized representatives of the account holder or parent company have on-line real time access to the balances to
International Cash Pooling

the participating accounts and can initiate credit and debit transfers electronically on an as-needed basis. Typically the bank simply acts as a conduit for the funds and has no right of set-off or appropriation against the account balances. One advantage of such an arrangement is that it allows the corporate customer to exert more control over cash-flows on as-needed basis than would be available through a zero balancing or daily sweep arrangement. A disadvantage is that more administrative resources must be allocated to monitor the cash needs of particular subsidiaries or business units, which may not be practicable in a large, complex corporate group.

Single legal account (also known as group account or balance netting) pooling, is a further type of cash concentration. This solution is based on a single, external bank account where all physical payments take place. Typically, the holder of a group account is the parent company or an incorporated separate funding unit. Other participants in the cash pool arrangement, such as subsidiary companies, deposit and withdraw assets to and from the group account through their individual virtual reference accounts (also referred to as transaction accounts), where the payments of each participant are mirrored. Hence, each legal entity will perceive the solution as if they have had their own physical bank account. When setting up a single legal account pooling, the old bank accounts of each subsidiary are usually closed and the monies are transferred to the group account. In connection with such transfer the transaction accounts can maintain the same old account numbers as the old physical bank accounts. This facilitates the transition phase as the subsidiaries’ interest groups do not need to be informed about any new account numbers. Usually it is offered as single currency arrangement, but also a multicurrency element can be incorporated if needed.

1.3 Chances and Risks of Cash Pooling

Many advantages can be achieved by a well set-up international cash pool. Not only does it enable a corporate group to minimise its expenditure for banking services, but mainly it is an important tool to guarantee for a filled war chest for possible future transactions. Only if the maximum financial strength of a corporate group is bundled, a holding company might be able to react quickly enough to market opportunities or threats.

Cash pooling is applied by companies and corporate groups because of its diverse advantages. As cash pooling gathers all liquidity in a corporate
group onto one bank account, the parent company receives information on the cash flow of the single corporate group members and can detect problems such as non-profitable companies faster. Further, existing banking contacts can be reduced and streamlined to a necessary minimum; better conditions can be negotiated with the bank (or banks) which will be used for the cash pool system. This leads for example to minimisation of the costs for loans from the respective bank for each of the group members. Moreover, cash pooling creates an optimal capital allocation. This helps to use dead capital in other business areas which are more profitable. In addition, a cash pool system optimises the interest income of the corporate group.

However, there are also disadvantages which come with cash pooling. Particularly the participants of a cash pool which give their surplus cash away have disadvantages. Subsidiaries which do not have own liquidity and take up loans from the pool leader do not enter any risks. Conversely, the subsidiaries which pay their liquidity to the pool leader bear the risk of not being paid back. This risk does not only exist because of the risk of crisis and insolvency of the parent company, but also because of the risk of crisis and insolvency of several subsidiaries which then need liquidity. In addition, those subsidiaries giving liquidity to the cash pool might not get as high interest rates for these intra-group loans as if they invested their liquidity by themselves.

1.4 Cash Pool Agreement Structure

When setting up a cash pool, different agreements have to be concluded. There is the cash pool agreement which is concluded between the participants of the cash pool and there is the agreement between the participants and the respective bank (or banks). The cash pool agreement includes all terms and conditions necessary to define and shape the cash pool system. The agreement with the respective bank contains all provisions for the keeping of the accounts as well as special provisions for the operation of the cash pool system.