

Common within a single country and single currency, pooling on a global basis presents a series of challenges.

"Moving liquidity locally is easy, regionally it's more complex, and global it's still more theoretical than practical," said John MacHale, Vice President, Cash & Treasury Services, Bank of America, Dublin.

"But global banks are developing the systems required to overcome the challenges of currency, geography, and corporate governance to make pooling on a global basis work as well in practice as it does in theory."

Managing liquidity globally is possible because of the sophisticated information systems used by banks and companies.

"We all have access to information on a real-time basis," John noted. "Before you can unlock liquidity, you need to know where liquidity is."

With all the real-time banking tools available, companies generally always know the real cash balances in all their accounts worldwide.

Pooling Possibilities

The purpose of pooling is to make the best use of a company's net cash position at the end of the day. Pooling provides two major advantages. First, when cash is consolidated in a pool at the end of the day, the entire "pool" balance can be invested over night, resulting in greater returns. Second, operating accounts that may be overdrawn at the end of the day have their deficits offset by accounts with positive balances.

"Anywhere there is an overdraft position overnight, you are probably giving up 300 basis points to the bank that is funding that position," John said. "To the extent that you can deploy your liquidity to fund that overdraft yourself, you can pick up 300 basis points."

Companies use two basic techniques to pool cash and manage liquidity:

1. Zero balancing or sweeping
2. Notional pooling

Zero Balancing/Sweeping

This pooling technique transfers funds at the end of the day to a single pooling account from the company's individual operating accounts; liquidity is concentrated in a single account. Because the balances on all operating accounts are brought to zero, regardless of whether they were positive or negative at the end of the day, all overdrafts are automatically eliminated at the operating level. "You have a deployable and identifiable level of liquidity to use," John said.

One of the challenges of zero balancing is that treasury managers at operating subsidiaries have to learn to work with a bank account with no money in it. Most subsidiaries are used to managing their own receivables and payables. With a zero-balance account, they may be nervous when they see that their excess balances are swept into a common pool.

"You need to work with people on ground and tell them that part of their day to day responsibility doesn't concern them anymore," John said. "That can be difficult."

Notional Pooling

This pooling technique results in the same net cash pool as zero balancing but is done under an agreement between a bank and its corporate client that bank will treat all subsidiary accounts as a single account for purposes of interest calculation. Funds are not actually transferred, and the bank makes the pooling calculations on its books. "It's a notion, a pretence, that it's a net balance when it's really a collection of positive and negative balances at a bank," John said.

Notional pools are generally set up in a location with favorable tax and regulatory rules, such as the United Kingdom, Belgium, or the Netherlands. Separate country accounts are still maintained but funds are swept into "mirror" accounts based in a single branch to gain the best tax and regulatory treatment.

For example, in common with a number of other large cash management banks, Bank of America uses its London branch for notional pool accounts. Funds are transferred to "mirror" accounts in London from local operating accounts at the end of the day. At the beginning of the next day, funds in the local accounts are swept from the London branch back to their original branch.

Currency Considerations

Sweeping is typically a single-currency technique and is extensively used in the United States. Since the introduction of the euro, sweeping has become common in Europe as well.

"With the euro, a company can emulate the liquidity management techniques used in the United States with the dollar," John said. "It's made a huge change in the way liquidity can be managed."

Notional pooling also tends to be a single-currency technique, and again the euro has greatly enhanced notional pooling as a liquidity management technique. Although balances are not swept into a single account, the euro has reduced the need to convert currencies into U.S. dollars or sterling for purposes of creating the pool. It is possible to overcome the currency, geographical, and corporate considerations and hand off a single currency position from region to region around the globe.

Border Woes

Geography becomes a critical factor when pooling reaches across borders. Although it may be easier to unite a company's cash position in a single currency, it's still challenging to move currency across geographical borders.

Cross-border payments are expensive in Europe but they remain the primary means of making payments between countries. Automated clearinghouse (ACH) transfers cost much less but they are restricted to single-country payments.

"We are left with the legacy of separate currencies," John said. "Each country has its own ACH system, and we are not likely to see a single European ACH for some time."

Companies setting up cost-effective cross-border pooling arrangements tend to use banks with a presence in the countries they want to include in the pool. Cross-border wire transfers are not necessary under those circumstances because the bank can transfer the funds from country accounts to pooling accounts through its internal systems, rather than through external payments systems. That eliminates the expense of cross-border wire transfers.

Corporate Concerns

In a perfect world, a single corporate entity would operate around the globe. Business would be easier because it would be done through one corporate body and one ownership structure. Accounting and tax considerations, however, suggest other structures. "Multiple-entity structures are the rule for operating and tax reasons," John noted.

Understanding how pooling weaves into a company's web of corporate structures is critical for the same reasons, as the following situations suggest:

- If one subsidiary is lending to another subsidiary, which is the case with sweeping, then the subsidiaries must have documented loan agreements between them. All interest paid and received as a result of funds sweeps must also be accounted for, which can put a heavy burden on company accounting systems.
- If the subsidiaries are set up as separate companies and they pay interest to each other, which happens when sweeping results in funding a negative balance for a subsidiary, then the company that received the interest may be subject to holding taxes.

With multiple entities, notional pooling seems to be the best technique for avoiding tax and accounting problems. "You need to get your tax advisor involved when you start pooling," John said.

Pooling is not financially transparent to the corporation or bank. After September 11th and the accounting scandals, accounting for the inter-company loans may draw scrutiny from corporate officers, and the treatment of notional pools on bank balance sheets is likely to draw further examination from bank regulators.

The Ultimate: Global Liquidity Management

Despite those concerns, however, pooling in general and notional pooling in particular can be used to bring global corporations closer to the ultimate: global liquidity management. "Administration is difficult, but the benefits are extremely significant," John said.

Global liquidity management, in which a company can take capital anywhere in world, has been theoretical until only recently. Because time zones overlap in the three business regions of the globe (the Americas, Asia, and Europe), it's possible for a global company to hand off a single currency position from one regional treasury operation to another.

"Large companies can afford to roll liquidity from treasury to treasury, and they do it," John noted. It's common for an Asian treasury to pass on its liquidity position to Europe at the start of a business day. Passing a liquidity position to the United States from Europe is not common because U.S. companies generally like to keep on-shore and off-shore liquidity separate, largely for tax reasons.

Some of the administrative difficulties arise from the conversion of all currencies into a position in a base currency, such as U.S. dollars or euros. Both the pool account and the local accounts must be within the same banking institution so that they can be rolled up into "mirror" accounts in a single branch to create a notional pool and then converted into a base currency.

At that point, the euro or U.S. dollar position is treated as a notional pool for purposes of interest calculation and investment.

"You still have a single pool of cash to deploy, and you still have the 300 basis point gain because there are no overdrafts. Accounts are still separate and interest is paid to or received from the bank, so intercompany loan documentation or accounting is not required," John said.

The bank that provides the multi-currency pool must also make sure that interest is paid or received in the currency of the original balance, not the base currency.

Given those complexities, a notional pool that includes different currency positions probably would not be worth the cost, if all a company gains is five to 10 basis points in additional investment income. But if a cross-currency notional

pool can eliminate overdrafts in company accounts around the globe, then the estimated 300 basis point savings per account is worth the cost. "The investment gain is minimal but the overdraft elimination is real," John said.

Advantages and Disadvantages of Pooling Techniques

Pooling Technique	Advantages	Disadvantages
Zero Balancing	The transfer of funds results in a "cleaner" transaction.	The need to account for interest on inter-company loans results in an accounting burden that many companies cannot handle.
	Highly developed and easily understood.	Documentation is onerous.
		Burden of documentation falls on the corporation.
		Cross-border funds transfers are expensive.
		Funds transfers that result in loans to subsidiary accounts must be tracked and charged at market interest rates.
Notional Pooling	Tax and accounting rules differ from country and country.	Documentation is onerous.
	Burden of documentation falls on the bank.	In the post-9/11 and post-accounting scandals environment, notional pooling may come under increased scrutiny and requires precise explanation.
	Cross-border transfers are not necessary as the pool is accounted for on the bank's books.	