

Cash Pooling

Improving the Balance Sheet



TABLE OF CONTENTS

Introduction.....	2
Background.....	3
Pooling Mechanics	4
Notional Pooling	4
Set Up Considerations	5
Physical Pooling	6
Choosing an Approach	7
Pooling Service Providers	8
Assessing the Costs	9
Tax Considerations	11
Basic Requirements	11
Account Structure	12
Tax Treaties	12
Domestic Tax Rules	13
Withholding Tax	13
Summary.....	14

Introduction

Effective balance sheet management focuses on two areas: working capital improvement and cash optimization. Elements of the working capital cycle – receivables, payables and inventory are often not under the direct control of treasury. Also, the process improvement approach that is key to working capital management requires acceptance and input, not only from other areas of the company, but customers and vendors as well; a time-consuming and expensive process. But when it comes to controlling the overall liquidity of the organization, “treasury rules”, as the assets to be managed are already monetized, and therefore a treasury responsibility.

In order to effect change in liquidity, treasury can implement specific management techniques using banking and treasury systems. The most common approach is through cash pooling – offsetting cash deficits in one business entity or country with surplus cash in another entity or country. The benefits of pooling come from the elimination of the bid/offer spread on these funds, improved visibility and control of cash, and often reduced administrative and bank service charges. There are various approaches to pooling so understanding the nuances – and tax implications – is important. One thing is clear, if done correctly and with support from effective tax counsel, implementation of a pooling system can yield significant ongoing benefits for the company as a whole, and can definitely improve the overall balance sheet.

Background

Pooling is a common treasury technique that can improve the balance sheet through efficient use of internally generated funds in order to reduce short term borrowing costs and maximize returns on short-term cash. Cash pooling was originally used to describe a notional technique for offsetting cash deficits with cash surpluses within a corporate grouping – a banking structure that mimicked accounting treatment, but on a day-to-day basis. It now refers to the offset of deficits with surpluses however it is achieved. Pooling can be accomplished through physical or notional means, and is usually handled through a banking arrangement. Either technique requires the use of a single bank, although multiple pools can be set up through different banks. Both approaches achieve the same objective, the use of cash surpluses to fund cash deficits. The main differences are:

Physical pooling must be done on a currency-by-currency basis and requires the use of intercompany loans for transactions to and from the pool accounts. Physical pooling is actually a form of cash sweeping or cash concentration with the addition of multiple divisions or subsidiaries. The separation of divisional or subsidiary activity is achieved through zero balance sub-accounts.

Notional pooling can be achieved on a currency-by-currency or on a multiple currency basis. However, the simplicity of the concept and structure mask a number of tax and regulatory issues that must be addressed. And it is often the case that resolving the issues negates the benefit of the notional pooling structure.

It is possible to operate a global pooling system, but practically speaking, pooling is most common as a single country or regional arrangement. Businesses operate in different time zones, using varying banking platforms and

with multiple cut-off times, making it extremely difficult for a large multinational company to manage all of its liquidity simultaneously on a global basis. Most companies establish sub-pools in key regional locations that take advantage of the intra-regional bank rules that frequently favor local countries. Further, the rules of some countries effectively restrict the ability of local affiliates to participate in any sort of pool.

Pooling on a regional scale is most common in Europe because of the Euro zone's reliable financial infrastructure and a favorable tax and regulatory climate. It is less used in Asia/Pacific, primarily for regulatory reasons and virtually unknown in Latin America due to FX restrictions and the withholding tax implications of intercompany lending. In the US, pooling is achieved exclusively through physical means as IRS regulations prohibit notional pooling, and is generally referred to as cash concentration or zero balancing.

Pooling Mechanics

NOTIONAL POOLING

Consider the case of three subsidiaries A, B and C operating in the UK who want to pool US dollars. The credit interest rate offered by their common bank is 3.0% and the overdraft, or debit rate of interest is 6.0%.

	USD Position	Interest Earned or (Paid)
A	100 USD	3 USD
B	40 USD	1.2 USD
C	(50) USD	(3) USD
Un-pooled	NA	1.2 USD
Pooled	90	2.7 USD

In a notional pooling arrangement, A, B and C would open accounts at the London branch of their UK bank and enter into a notional pooling arrangement with the bank. A, B, and C would operate their businesses – and their accounts – independently while their accounts were pooled. The benefit of notional pooling, as this example shows is that while the company earned 1.2 USD on its position before pooling, after pooling it earned 2.7 USD, a benefit of 1.5 USD.

NOTIONAL POOLING

Notional pooling refers to the offset of consolidated cash surpluses and deficits that result from the varying positions in separate bank accounts. In the notional pool banking arrangement, each company participating in the pool maintains its own account or accounts in the currencies being pooled. The bank then creates a shadow or notional position from all of the participant accounts reflecting the consolidated cash position. The consolidated position achieved through this notional arrangement is the position on which interest is paid or charged. Because there was no movement of funds to calculate this position, the pooling is referred to as notional and the legal and tax separation of the pool participants – that ultimately share a common parent – is maintained.

Because of its simplicity and ease of operation, notional pooling is the technique of choice for single currency pools within a particular country. Notional pooling is not permitted in all countries, notably the US and Germany, where tax authorities consider it to be a co-mingling of funds. Countries where notional pooling is most common such as the UK, Netherlands and Belgium, have minimal or no withholding tax on interest earned in a pooling arrangement, but there may be country-specific interpretations that require a holding company to function as the pool manager; this applies in the UK, for example.

Also, there is an issue of how a bank accounts for this pooling arrangement on its balance sheet, an important matter for regulatory authorities in the country where the pool operates. This may entail documentation requirements, such as cross guarantees, for the pool participants. The logic behind this is that deficit balances from pooling participants appear as assets on the bank's balance sheet. But since the bank does not earn interest on these assets because of the notional offset with participant

SET UP CONSIDERATIONS

An important consideration in setting up a pooling arrangement on a cross-border basis, either physical or notional, is the degree to which the pooling structure is integrated with the local daily transactional activity.

If collections and disbursements are handled outside of the pool, through different bank accounts, then the pool acts merely as an overlay. Funds will need to be transferred from the local in-country bank account to the overlay bank's in-country account. Obviously, this arrangement is sub-optimal, it increases the overall number of bank accounts and the associated charges. Inevitably funds will be left in the unpooled local account to allow for clearing payments.

Using a single bank for both transactional banking and pooling in a region creates another set of issues, as the banks capable of offering pooling do not necessarily have full branching capabilities in every market. Thus, there will be a reliance on correspondent banks, strategic partnerships or specialized network arrangements. These can work very well or be a source of ongoing headaches and hidden costs, thus the design of the overall structure must take into consideration not just the pooling itself, but how it integrates with the day-to-day working capital management.

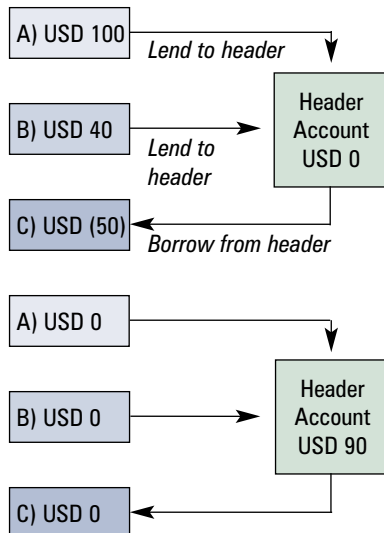
surpluses, they could be considered non-performing loans unless the bank has a clear right of offset. The guarantees enable the banks to prove the right of offset and the right to use surplus funds to cover deficit positions. The requirement for cross guarantees does not apply in the Netherlands, which serves to explain the popularity of the Netherlands as a location for notional pooling.

Notional pooling takes on significant complexity when it expands from a single country to multiple-country arrangement. This is due to the cross border and potentially cross currency nature of the pool.

When dealing with more than one currency, even within the same country, it is necessary to bring the currencies to a common base currency, usually the Euro or US dollar, before the pooling and interest offset can take place. One technique for doing this is through a short-dated swap. Another is through a notional conversion to a base currency with the risk covered through the adjustment of the interest rates paid or charged in each currency. Either approach makes the process more problematic and less cost effective as the bank's desire to be compensated for its risk takes place at the expense of the corporate client pooling its funds.

Even the advent of the Euro, which simplified the FX component of the process, did not fully mitigate the difficulties of cross-border notional pooling. There is still the need to accommodate multiple regulatory regimes, demand deposit accounting (DDA) platforms, dealing rooms and cut-off times. The traditional clearing systems, such as TARGET, require a physical movement of cash to concentrate the Euro position in one location. Even when a pan European bank substitutes its network for the clearing systems, managing the "book" takes effort.

PHYSICAL POOLING



This example takes the same corporate position as that shown in sidebar 1 and illustrates the physical location of the cash before and after physical pooling. A, B, and C open accounts with a common bank and arrange to have the accounts linked in a sweeping/zero-balancing arrangement. A and B which are in surplus lend funds to the header account of the pool which in turn lends some of these funds to C which is in deficit. The benefit of notional pooling, as this example shows is that while the company earned 1.2 USD on its position before pooling, after pooling it earned 2.7 USD, a benefit of 1.5 USD. The top diagram in this example shows the accounting treatment of each entry in the physical pool.

PHYSICAL POOLING

Physical pooling is often referred to as zero balancing. It can be achieved on both a single country and cross border basis, but only currency-by-currency. Zero balancing (ZBAs) and cash concentration have a long history in the United States. The drivers behind efficient physical pooling in the US were Regulation Q, which prohibited banks from paying interest on demand deposits, and the large number of banks a company needed to operate in the US before the repeal of restrictions on interstate banking.

As with notional pooling, each division or subsidiary maintains its own bank accounts, which are normally sub-accounts linked to a main or header account. These accounts can be maintained in any location permitted by law and, more importantly, where efficient payment, clearing and bank systems allow for rapid and inexpensive movement of money between accounts.

Each division or subsidiary conducts its commercial operations, paying and receiving money, ideally through the sub-accounts. At the close of each business day, all funds in the divisional or subsidiary accounts are physically transferred to the main account usually maintained in the name of another legal entity, such as the parent, a regional subsidiary, or a finance company – whatever is best from both a practical and tax perspective. The net position in the main account is either invested or funded through a centralized credit facility. The movements of money to and from divisional or subsidiary accounts are generally treated as intercompany loans unless all movements take place within the same legal entity.

Choosing an Approach

Notional pooling, which relied on bank accounting systems was the popular choice in the 1980's and early 1990's. The advent of the Euro and systems improvements, both corporate and bank, along with more thorough scrutiny of the balance sheet implications of notional pooling techniques by regulators, have now shifted this preference dramatically in favor of physical pooling. Major bank respondents to a recent RFP administered by Treasury Alliance Group indicated that their client base adopted physical pooling as opposed to notional pooling by a margin of more than 5 to 1. The specific factors driving this change include:

- **The Euro Zone** – Countries within the zone can be handled through a single physical pool. This dramatically reduces the number of accounts that need to be maintained and the related accounting and administrative requirements.
- **Cash Visibility** – Virtually all cash is now visible through web-based solutions allowing nearly instant viewing and access to all accounts in the pooling arrangement.

- **Corporate Systems** – Most companies now manage their accounting via an ERP system. This makes the booking of intercompany loans – mandatory with a physical pooling – a simpler task. And where a corporate system cannot, or is not used to perform this function, third-party systems can easily handle the booking of loans.
- **Bank Systems** – The pan-European banks have integrated and consolidated their operating platforms across the region. In some cases, even if an account is nominally maintained in France, the demand deposit accounting (DDA) system supporting the account is physically located in the bank's European processing center, which could be in the UK or the Netherlands.

Notwithstanding these points, the appeal of notional pooling as a simple solution remains – it is an excellent approach for mitigating the costs of periodic fluctuations between positive and negative positions in short-term cash. Notional pooling is a convenient way for companies to capture the deposit/borrowing spread earned by financial institutions, but is not a substitute for strategic intercompany financing or proactive investment strategies.

From a cross-border perspective, notional pooling also works effectively if a company has just acquired overseas operations. Or, where treasury has limited control over local banking arrangements but still wants to be able to manage global liquidity as effectively as possible. It allows an overlay that will not disturb the existing banking structure.

Locally, notional pooling is an ideal tool in countries such as Brazil, where there is a debit tax levied on cash payments from bank accounts. Physical pooling between separate legal entities would trigger the tax; so notional pooling is the logical choice.

Notional pooling is less effective as a solution when:

- The company has a long-term or permanent mismatch between cash positions. In this case, formal intercompany loans would be used as the most appropriate balancing mechanism.
- All operating companies are in a long-term surplus cash position. With this positive liquidity situation, the company should place excess cash in higher yield investment instruments, by currency. In this case, using ZBA arrangements in order to bring up all excess cash to single currency pools is the preferred option.

Pooling Service Providers

For single country, stand-alone pools, an indigenous bank can be the preferred pooling provider. Their branch network, operating capabilities and likely roster of existing pooling clients give them a pricing and experience advantage. Where the pool will be integrated with other currency pools, or operate on a cross-border basis, pooling services are typically obtained from the large global banks. Because the global banks do not have in-country infrastructure comparable to the indigenous banks, it is quite possible that the global bank may partner with one or more local banks to provide the required services.

This is because the most cost-effective pooling solutions link the liquidity management benefits offered by pooling with the transactional services for receipts and disbursements required to operate a business in each country. The simple addition of a pool bank as an overlay, without any change to the local banking structure, adds considerable cost due to the extra layer of accounts required, transac-

tion costs in moving funds to and from the pool bank and potentially loss of interest on funds that are “in-transit”.

While the regulations governing pooling systems are the same for each bank the global banks tend to take slightly different approaches from each other reflecting their different operating systems and technology infrastructure. It is therefore advisable to solicit proposals from more than one bank. Finally a word of caution, the old saying “if your only tool is a hammer, then every problem is a nail” applies to the selection of a pooling provider. Their proposal should represent an accurate response to your request for proposal or an improvement based on their understanding of the circumstances.

Following are brief abstracts of service offerings from the global banks.

ABN Amro offers in-country, regional and global pools through branches and strategic partners in Europe, Asia/Pacific and North America.

Bank Mendes Gans (ING Bank) offers niche cash management solutions including regional and global pooling facilitated through correspondent banks or the company's existing banking network.

Bank of America offers in-country, regional and global pools through branches and strategic partners in Europe, Asia/Pacific and North America.

Citibank offers in-country, regional and global pools through branches and strategic partners in Europe, Asia/Pacific, North America and Latin America.

Deutsche Bank offers in-country, regional and global pools through branches and strategic partners in Europe, Asia/Pacific and North America.

HSBC offers in-country, regional and global pools through branches and strategic partners in Europe, Asia/Pacific and North America.

JP Morgan Chase offers in-country, regional and global pools through branches and strategic partners in Europe, Asia/Pacific and North America.

Assessing the Costs

The cost of pooling systems varies widely depending on the complexity and scope of the structure, the financial institutions involved, and the degree to which the pooling structure can make use of existing arrangements such as bank accounts, information reporting and treasury management systems. Broadly speaking there are four categories of cost to evaluate: implementation, maintenance, transactional and opportunity cost.

1. Implementation costs assessed by banks include setup charges for the basic pooling system, out-of-pocket reimbursement for certain types of on-site technical support and license fees for any bank systems used. Depending on the bank relationship, these charges may be waived. But as they are real costs to the bank, the bank will be careful to recoup costs in other areas to ensure that overall profit targets are met.
2. Maintenance costs may include account maintenance, statement rendition and software servicing/upgrading.
3. Transactional costs include wire and book transfer charges. The number of possible charges is limited only by the creativity of the bankers assessing them and the trick is to worry less about specific items and focus on the “run cost” of the pool. To do this, the bidding banks should be asked to prepare an estimated monthly “run cost” based on the proposed pooling structure and volumes. This will go a long way to eliminating pricing surprises once the pool is up and running.
4. Opportunity cost is much more difficult to manage. Opportunity cost arises because in virtually any pooling arrangement the bank will have use of use of the company’s funds for a period of time. The bank may provide account services for a nominal fee in return for providing pooling services. The opportunity costs in an embedded compensation scheme like this can be difficult to measure. For example:
 - a. The rates applied to balances may be slightly below the rates a company could achieve in the money markets.
 - b. A spread may be taken in the notional conversion of pooling currencies to the base currency of the pool. Where conversion is achieved through the use of interest rate differentials the interest rates may be less competitive than what a company could obtain otherwise.
 - c. The type of instrument for investing surplus funds and its tenor is selected by the bank, not the company.
 - d. If the pooling bank does not provide the basic operating accounts used by the participants, another layer of bank accounts is required. This may necessitate a manual transfer to the pool accounts or a loss of value.
 - e. If there is a currency movement against the pooled currency, the parent company will have to purchase currency in order to bring the pool back to the “zero” level.

RESTRICTIONS AND BEST PRACTICES

Country	In-country Pooling	Regional Pooling	Best Practice
Argentina	No	No	None
Australia	Yes	Yes	Notional
Belgium	Yes	Yes	Notional
Brazil	Yes	No	Notional
Canada	Yes	Yes	Physical
China	No	No	None
France	Yes	Yes	Notional
Germany	Yes	Yes	Physical
India	No	No	None
Italy	Yes	Yes	Physical
Japan	Yes	Yes	Physical
Mexico	Yes	No	Physical
Netherlands	Yes	Yes	Notional
Singapore	Yes	Yes	Notional
Taiwan	No	No	None
United Kingdom	Yes	Yes	Notional
United States	Yes	Yes	Physical

More significantly, if the bank performing the pooling is not a member of the payment and clearing systems within a given country, the cut-off times for investment may reflect the bank's need for an intermediary. This can change a late-afternoon cut-off time to the midday which, for a European pool means the loss of a full day's interest for US balances and about half a day for European balances.

With physical pooling, pricing is typically more transparent. The banks charge fees and do not need to take a portion of the interest spread, thus investment rates applied are usually higher. Also, the charges can be assessed on the sub-accounts, a monthly fee for the sweeping or a combination of both. Thus, funds can be pooled on a daily basis at a fixed cost with no idle balances remaining in the accounts. Finally, the company may already be paying fees for web-based reporting and other ancillary services. As these may be used for ongoing treasury operations, they should not necessarily be considered incremental costs of the pooling structure.

However, physical pooling places additional requirements on the treasury manager. Specifically:

- Funds remain in local currency and there is no notional FX conversion. If there are positive/negative positions between currencies, treasury can make the decision to offset through a series of short-dated swaps.
- There can be two levels of investment. The pool header accounts should earn a competitive rate of interest on an overnight basis, but treasury may choose to move funds into higher yielding investments as required.
- All balances are by currency, allowing treasury to clearly view the FX risk profile and make logical and cost-effective hedging decisions.

Tax Considerations

Regardless of the pooling approach selected, tax considerations are of critical importance. For example, there can be deemed dividend issues in any pooling arrangement – notional or physical. Deemed dividends arise when the allocation of the interest benefits, or cost, of the pool to each participant takes place at arbitrary rates with the effect of avoiding taxation. Because intercompany loans are in place with a physical pooling arrangement and arm's-length interest is charged, paid and documented, there is a high degree of transparency in the pool. With a notional pool, the situation from a tax perspective is more ambiguous and therefore is a source of concern to many company tax directors and their advisors.

Favorable tax treatment is another important factor in deciding whether to use notional or physical pooling. In this case, it is not the merits of a particular pooling technique that are at issue – assuming they are both permitted. Instead, it is the content of the underlying agency agreement in place between the owner of the main pooling account e.g. a corporate treasury, a BV, a BCC or an IFSC, and the pool participants that will determine the

tax treatment. This explains why two companies with outward similarities may take different approaches to pooling.

Of course the presence or absence of withholding taxes in the country or countries where pooling is contemplated is influential on the choice of pooling method. The very nature of pooling with its implicit or explicit charging and paying of interest makes withholding tax treatment one of the most important considerations in establishing a pooling arrangement.

BASIC REQUIREMENTS

Virtually all liquidity management structures, whether physical or notional must comply with three basic requirements from a tax perspective.

1. *Arm's-Length Interest*

Allocation – All financial arrangements between participants, such as credit lines, cross-guarantees and interest rates should reflect an arm's-length, or “market” price. While the pool manager may have discretion in allocating the interest income and expense among participants, this interest allocation cannot be arbitrary. The concern is that the pool may be used to

shift income from one jurisdiction – or entity – to another in order to reduce the tax burden.

2. *Business Purpose*

– The entire structure must have a valid business purpose other than tax avoidance or the circumvention of non-tax regulatory restrictions. Pooling structures typically meet this requirement as the net lending and net borrowing positions of the participants are of a short-term nature and comparatively small amounts, and the primary purpose of the structure is the efficient management of liquidity.

3. *Economic Substance*

– The participants must have formal, legal responsibilities surrounding their participation in the pool including the need to pay interest, suffer interest rate risk and the risk of default by a counterparty. Cross-guarantees, cross-indemnities and other rights of offset – protective measures used by banks – also serve to establish economic substance and need not be a concern as long as all participants are legitimate and solvent. Intercompany compensation at arm's-length rates with respect to guarantees provides additional support.

ACCOUNT STRUCTURE

A key consideration with account structure is whether or not the owner of the main pooling account is acting as the principal for the group or as an agent on behalf of the participants. When the owner acts as a principal then interest earned or charged will be considered to be intercompany interest. If the main account owner is acting as an agent for the participants then similar interest will be considered to be bank interest – and taxed accordingly. Therefore the definition of interest is a key determinant of tax treatment and the type of interest will affect the allocation back to the participants and how they are taxed in their respective tax jurisdictions.

Two other issues to be aware of are:

- Many companies set up a finance vehicle in the Netherlands or elsewhere with minimal capital, and this may dictate that they cannot charge management fees. However, when they act as an agent in a pooling arrangement this gives the finance vehicle treasury functionality. And, this may raise concerns about thin capitalization and its consequences.

- If the main account owner is the treasury of a US parent, then subpart F restrictions will likely trigger treatment of pool earnings as deemed dividends. This effectively precludes direct participation by the US treasury in any non-US pooling arrangement.

In selecting the best location for the treasury center – from a tax perspective – there are four areas that require careful consideration by companies and their tax advisors. They are: account structure, tax treaties, domestic tax rules and withholding tax.

TAX TREATIES

Every country has a network of treaties with its trading partners, providing different levels of tax concessions for international transactions. The level of concession depends on the treaty partner. Certain countries have a highly developed treaty network that facilitates operation of a treasury center. Their treaty network provides benefits such as low or no withholding tax on cross-border interest, dividends and capital gain payments.

The simple existence of a treaty network does not automatically

guarantee treaty benefits to all participants. For the treasury center of a multinational to qualify for the treaty benefits, it must be a resident company in each of the treaty countries. That is, it must have a substantial business presence in the treaty country. Tax treaties contain rules to protect against sham operations, nominally resident in the country, but actually set up to take advantage of a favorable treaty benefit. For example, some rules attempt to determine the true identity of the true party-in-interest, or ultimate beneficiary, from a series of intercompany loans or other transactions. Advance planning is important in getting the most out of tax treaties.

This would include the use of “capital blockers” in which funds are contributed as equity and withdrawn as loans. These rules must be reviewed in detail and applied to a company’s particular situation.

When evaluating a number of attractive locations for the treasury center, factors extending beyond tax may ultimately tip the balance. Human resources must be considered; does one location have more activity or more financially skilled personnel? Would the treasury operation require relocation of

qualified employees or the hiring of experienced local staff? And, particularly for US multinationals, does the specific location require that financial management and decision making be made by local nationals, such as is the case for the UK.

It is important to recognize that the domicile of the bank accounts supporting the treasury center does not need to be in the same location as the entity that is controlling the accounts. Simply put, it is not necessary to physically locate the bank accounts supporting a Swiss company in Switzerland when the banking infrastructure in the UK is more suitable. The Swiss company will hold a non-resident account in the UK. Tax and other logistical drivers determine the location of the pooling entity.

DOMESTIC TAX RULES

In addition to their network of tax treaties, countries have taxation rules applicable to the treasury center and other business activities of the company within the country. For example, some countries offer reduced local income tax rates to attract foreign investment. Equally,

others impose “thin capitalization” rules that deny interest expense deductions if local operations are highly leveraged – generating substantial interest deductions and minimizing the capital “at risk” in the country. These rules can apply even if the intent of the local borrowing is to be part of a conduit, pass-through treasury operation. Also, if the company is considered non-resident, some countries will limit or forbid its participation in a local pool.

WITHHOLDING TAX

Cross-border treasury management involves the payment or receipt of fees for services and interest payment or receipt on lending or investment activities. These revenue and expense streams are often subject to withholding taxes when the recipient of the service pays money to a treasury service provider located in another jurisdiction.

The withholding tax “leakage” will depend on the income tax treaty network between these two jurisdictions. If there is a tax treaty, the withholding tax on the interest

payment can be reduced or eliminated. For example where a US Company pays interest expense to a European treasury center, the withholding tax can be reduced from 30% to zero in many instances – because there is a tax treaty in place between the US and the European country in which the treasury center is located. Conversely, similar payments to an Asian or Latin American treasury center will result in higher taxes, in many instances at the full 30% rate.

Treasury service fees can also be subject to a withholding tax depending upon the location of the service recipient and whether or not a treaty exists with the treasury center’s jurisdiction. Any profit repatriations from the treasury center to its shareholder in the form of a dividend will be subject to withholding tax considerations. For dividends, the withholding taxes could be reduced either under the domestic tax legislation of the treasury center’s jurisdiction, or under the tax treaty between the treasury center’s jurisdiction and the jurisdiction of the shareholder.

Summary

The management of a pooling arrangement is relatively straightforward once the analysis of pooling benefit, technical approach to pooling and location of the pool has been determined. Implementation is the biggest challenge. A notional pool/overlay using existing banking arrangements is easier and less disruptive to implement than a physical pool; all that is required is the opening of a few accounts and execution of the required banking documentation.

Physical pools require a more complex implementation. This is because the most cost-effective pools combine the operating accounts used by the businesses

with the accounts required for physical pooling. The result is that the existing in-country account structure may need to be modified and accounts shifted from existing banks or branches to new banks or branches.

Ongoing operation requires the administration of intercompany loans from an accounting perspective and active involvement on the part of treasury to insure active, effective oversight of investment, debt and related risk management.

In the case of both physical and notional pooling, implementation can take between six months and one year depending on the complexity and the dedicated resources supplied by the company

and the bank performing the pooling. A mutually agreed project plan with an experienced project manager is essential.

Pooling is a smart way for treasury to improve the balance sheet where there is the need to manage liquidity across multiple legal entities. Such an arrangement requires an initial assessment and cost benefit analysis, close collaboration with tax, an evaluation of overall banking requirements and a focused project approach to selecting the correct structure and banking services. It's not easy, but the benefits are clearly worth the trouble as more and more companies review and implement cash pooling arrangements.

GLOSSARY

TERM	DEFINITION
Currency Swap	An agreement to swap a series of specified payment obligations denominated in one currency for a series of specified payment obligations denominated in another. Used to convert positions in different currencies into a common currency for pooling purposes.
Header Account	The main, or top-level account in a pooling arrangement. The net balance in the header account is used to determine the interest paid to, or due from the pool.
Mirror Account	An accounting/banking arrangement where the entries made into one account are actually booked in an offsetting account leaving the original account remains in a zero balance position.
Multilateral Netting	A treasury management technique in which the payments and receipts among a group of participants, typically within the same company, are consolidated on a periodic basis, usually monthly, and participants then settle the net balance of their obligations to the other participants with a single payment, or receipt in their local currency.
Notional Pooling	The offset of interest income and expense that results from the varying cash positions in bank accounts maintained by different divisions or business entities of the same company. In a notional pool banking arrangement, each company participating in the pool maintains its own account or accounts in the currencies being pooled. The bank then creates a shadow or notional position from all of the participant accounts reflecting the consolidated cash position.
Overlay	A banking arrangement set up for liquidity management purposes that holds the net cash positions for all participants. The bank accounts in the overlay may or may not be the same accounts that participants use for their principal collection and disbursement activity.
Physical Pooling	The offset of interest income and expense that results from the varying cash positions in bank accounts maintained by different divisions or business entities of the same company. This offset of positions is achieved through the physical movement of money from one account to another. Physical pooling is often referred to as zero balancing.
Sub-Account	A bank account that is subordinate and linked to a principal account. Typically held by participants in a pooling or zero balancing arrangement, they are automatically linked to the header account.
Sweeping	The physical and automatic transfer of funds from one account to another. Typically used to move money from sub-accounts to header accounts.
Zero Balance Account (ZBA)	ZBAs are sub-accounts in a physical pooling arrangement linked to a header account. Balances are never maintained in the accounts, having been swept to the header account.

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