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Do You Keep Cash Close to (the Currency) Home?

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In this Treasury Management International article, Amy Goldstein, Managing Director, International Cash and Liquidity Management Sales, writes about the benefits of centralising USD in the United States and how it is often particularly compelling due to its status as an international trading currency and the high volume of cash involved.

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Centralisation has been a key theme in corporate treasury for some years, with many corporations successfully operating regional centres to support particular geographies. Increasingly, however, we see a trend towards centralisation by currency. Corporate treasurers have created account structures to centralise critical balances by currency in the ?home market? for that currency. The benefits apply to every currency; however, the value proposition of centralising USD in the United States is often particularly compelling considering its widespread use as an international trading currency and the high volume of cash involved.

The USD imperative

According to estimates by Capital Economics earlier this year, US companies are holding $2.5tr offshore: an increase of nearly 20% over the past two years, and equivalent to nearly 14% of GDP. In addition, non-US headquartered corporations, particularly from Asia, Africa and Latin America, frequently denominate and settle in USD. Given the scale of balances involved, and the ubiquity of the currency for world trade, optimising USD is critical for all companies operating internationally. Comparable value may also exist, for other major currencies such as EUR, GBP and JPY, depending on the materiality of balances and the nature of the organisation?s business model.

Keeping close to home

There are a variety of reasons why companies may consider centralising their USD (or other currency) balances in the currency home market.

Liquidity management

Looking first at US-headquartered corporations; many larger companies have regional treasury centres to support cash and liquidity management, while activities such as group financing, FX management, investment etc. are more often located at headquarters. As a result, there can be significant benefits to centralising USD in the US: keeping USD cash pools and residual balances close at hand and in the same time zone while benefiting from later cut-off-times to meet investment deadlines. For non-US headquartered corporations there are investment and payment efficiency benefits of centralising USD.

Investments

Having centralised liquidity, investment options are deeper in the currency?s indigenous market, with more access to markets and liquidity. This allows treasurers to meet investment and risk objectives and potentially provide value generation. At the same time, treasurers can manage counterparty risk more precisely by maintaining central visibility and control over exposures.

Payment and collection efficiency

There is also an opportunity to reduce costs of cross-border payments and collections, depending on the company?s supply chain, customer base and where suppliers are located. Cross-border flows are typically more expensive, take longer to settle. As value dating is sometimes unpredictable, companies often need to maintain a higher cash buffer or put in place larger than necessary intra-day overdraft lines. Reconciliation of incoming customer flows can also be more time and labour-intensive as remittance data is frequently omitted or truncated as part of the cross-border payment process. In contrast, by centralising a currency in its home market, the number of cross-border payments and collections can be reduced, allowing companies to leverage local clearing systems that result in reduced costs, improved reconciliation and greater efficiency.

Managing the pressure

Given the pressure on treasury to ?do more with less?, centralising funds on a currency basis can be an attractive proposition. Furthermore, the benefits of doing so are not limited to cash, liquidity and investment. For example, treasurers face a range of risk and regulatory challenges, including event risk, such as bank exits from certain product lines or markets. Managing the outcomes of this can be very taxing for corporate treasury and creates business continuity risk. Holding currency nearby at lower costs with access to the depth and breadth of the home market ensures that companies are best positioned to deal with market events. KYC requirements can also be complex and onerous, with differences in requirements between banks and markets, so centralising currencies into a single geographic location and therefore simplifying global account structures can reduce the compliance burden.

One question, however, is why treasurers have not chosen to centralise cash balances into each currency?s home market in the past. One reason is perhaps that the opportunity to do so has not always been clear. For example, in Europe, while the euro as a single currency has existed since 1999, the Eurozone effectively comprised multiple domestic markets with the same currency until the introduction of SEPA (Single Euro Payments Area). Therefore there were often either actual or perceived market or regulatory barriers to centralisation. Since SEPA payment instruments have replaced most domestic payment types, with a harmonised legal framework, more companies operating in different euro-based countries are now centralising euros into a single location. Although some domestic payment instruments remain and clearing systems in each European country have different characteristics, such as cut off and settlement times, these should not result in treasurers opting to fragment euro cash balances.

Many US companies believe that centralising funds held by offshore entities into the US creates a tax event. There are two areas of focus to consider here: co-mingling of funds and opening non-resident accounts on a stand-alone basis. Co-mingling of funds between entities registered in different jurisdictions creates a taxable event; the key is to confirm what that taxable event entails, be it double taxation treaties, thin-capitalisation rules or other issues. The opening of USD non-resident accounts in the US on a stand-alone basis is less clear and open to interpretation. There is corporate treasury precedence for both. Whenever considering these options, it is critical always to obtain independent expert tax advice.

Every country is subject to its own tax rules, so a centralised currency model cannot simply be replicated for every currency. Consequently, treasurers need to engage tax and legal departments, and their banking and other third party providers to understand the opportunities and benefits in each case. This includes exploring the way in which currency flows and exposures are currently managed, including payment and collection instruments used, the financing and investment products in place, and the applicable costs. The home market opportunities can then be explored, including optimal payment, financing and investment instruments, and any cost, liquidity or risk management advantages. This also involves looking at where customers and suppliers are located, and the potential impact on them.

Future planning

Treasurers need to anticipate and be prepared for disruptive events, and those that plan ahead by minimising risk in key currencies and maintaining centralised, flexible banking and treasury structures are likely to weather these events most successfully. Visibility and control over major balances is essential through good times and bad, and centralising cash in the currency home market can be a very valuable way of achieving this. There are a number of considerations to take into account, looking end-to-end across the supply chain, in which banks and service providers can offer advice and expertise. Investment in this process can reap considerable benefits, allowing treasury to increase its value to the enterprise and manage major currency balances cost- and risk-efficiently.

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