Cash optimization with multi-currency and virtual accounts

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In today's global marketplace, treasurers face the increasingly complex task of managing a corporation's liquidity. As multinationals expand their overseas operations, more and more bank accounts are being opened for different geographic regions, currencies, and business needs. With so many accounts, bank account structuring and management has become a significant responsibility for treasury departments. Transaction banks offer a variety of services to simplify cash management for treasury. Two popular services employed by most corporations are physical cash pooling with ZBA sweeps and notional cash pooling.

Notional pooling: regulatory hurdles

While physical cash pooling remains the most popular and most practical solution today, the popularity of notional cash pooling is declining due to tightening regulations such as IAS 32 and Basel III. IAS 32 requires notional pooling setups to be supported by legally enforceable rights to settle between the separate accounts involved in the notional pool (interpretation determined on a case-by-case basis (https://www.ifrs.org/-/media/feature/news/updates/ifrs-ic/2016/ifric-update-march-2016.pdf)). Meanwhile, Basel III extends the application of IAS 32 by requiring banks to account for negative notional account balances as liabilities in Basel III ratio calculations, increasing the cost for banks to offer notional pools as a service.

Due to these two reasons, corporates are again on the lookout for efficient and innovative solutions to allow cash visibility across regions and across currencies – the major benefits offered by a notional pool. Below, we discuss two concepts that may be applied in place of notional pools.

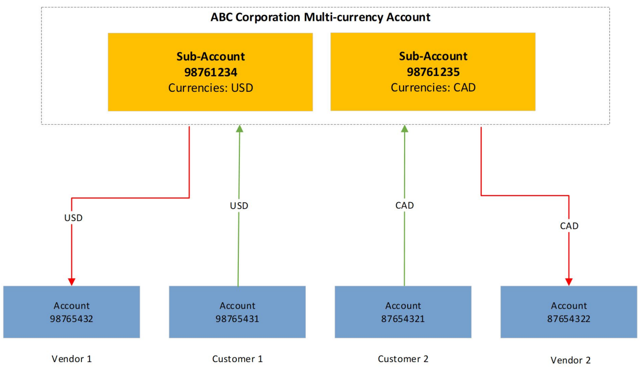
Multi-currency accounts

Multi-currency accounts are, as their name suggests, bank accounts in which balances are held in multiple currencies. For reporting purposes, these accounts are presented in both account currency as well as in a common base currency. The benefits associated with a multi-currency account include:

- Cash visibility through consolidated balances,
- Reduction of FX transaction costs/administration fees by allowing corporates to hold foreign currency without conversion
- Reduction of bank fees through bank account rationalization.

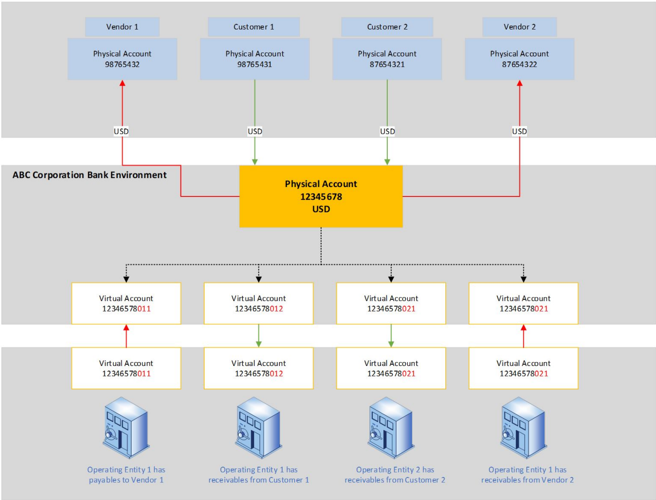
For businesses whose operations are local and who have few cross-border and cross-currency transactions, multi-currency accounts are an efficient replacement for a few FX transactions each period.

For corporations with larger volumes of FX transactions, companies may use the multi-currency account to make payments on behalf of or receive on behalf of local subsidiaries. Of course, having co-mingled funds give rise to accounting complexities but this can be simplified with the second solution described below.



Virtual account management

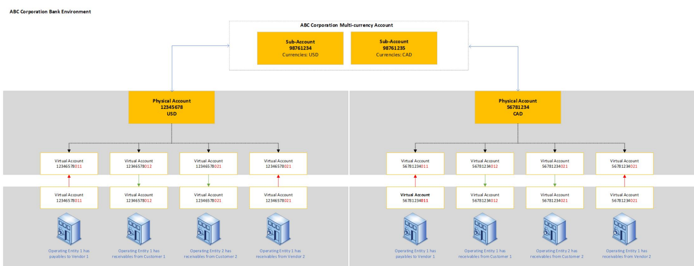
Virtual accounts are services offered by various banks that help large corporates pay and receive across multiple entities and businesses. Just like a real bank account, virtual accounts possess an account number and can be used to pay vendors and collect from customers. The difference between virtual and real accounts is that virtual accounts do not hold a balance and do not actually settle transactions. The transactions are routed to a real bank account for settlement and will then display an ending balance – it receives on behalf of (ROBO) and makes payments on behalf of (POBO) the virtual accounts.



Combining virtual account with multi-currency accounts

An area of further exploration is how businesses can combine virtual accounts with multi-currency accounts to create a structure where businesses can reduce FX costs and enable cross-region cash optimization, while keeping a simple local operating banking structure.

While currently in its infancy, virtual account management has the potential to extend to structures including multiple legal entities. With this capacity, virtual account structures or virtual IBANs can be established for local operations across multiple regions to facilitate collection and disbursements for business operations in those regions. At the end of the day, all transactions are settled in the master account with a positive or negative balance. The ending balances in the master account for each region can then be funded by or used to fund the multi-currency account, owned by the in-house bank or global treasury, creating a global funding structure that is cross-currency.



Conclusion

Given the demand for balance consolidation and account rationalization and the future regulatory uncertainty of notional pooling, multi-currency accounts used in conjunction with linked virtual accounts represents an innovative bank account structure that has the potential to both satisfy corporate needs and allow banks to comply with regulations while maintaining operational efficiency.

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