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Treasury and Trade Solutions

Moving Beyond "Trapped" Cash

Trapped cash typically occurs when countries have insufficient hard currency reserves. It normally results in the inability to remit currency offshore to pay for transfer pricing, intercompany settlements, and dividends. These countries are rare and include Angola, Argentina, and Egypt.

The topic of trapped cash frequently comes up in conversations. The tendency is to dive straight into the inability to repatriate cash out of certain countries. The crux is not that cash is trapped, but rather how to manage cash in countries with varying restrictions.

The Client Advisory Group recommends using the following framework to manage cash in countries with varying restrictions:

- Distinguish unrestricted, semi-restricted, restricted, and truly trapped cash countries
- Quantify the amount of cash in each category of countries
- Be aware of certain countries that have currency conversion constraints
- Understand the company's business and trading model
- Determine the company's finance and treasury model

An effective discussion takes *a broad view of a company's business, treasury, and finance models* rather than delving into a specific country or countries.

Country Regulatory Classification & Management

Countries can generally be classified as unrestricted, semi-restricted, or restricted, where regulations are concerned. Cash management metrics should measure performance based on classification.

- Unrestricted countries encourage free flow of capital whereby the local currency is freely tradable and normally available offshore
- Semi-restricted currency countries are those where the local currency is not available offshore. Normally, these currencies can be easily traded onshore against hard currency with proceeds lent offshore
  - Semi-restricted currency countries may have unique requirements, such as:
    - Currency to be lent (e.g., China – USD and CNH only)
    - Amount (e.g., Korea - $50 million cap)
    - Time (e.g., China – 1 year maximum loan tenor)
- Restricted currency countries are those where cash can only be taken out of the country via transfer pricing, dividends, or a return of paid in capital
- Trapped cash countries have insufficient hard currency reserves and repatriating cash is generally not possible

Company Business & Trading Model

Next, understanding the company's internal goods and services flow and transfer pricing model entails the following commercial considerations:

- Determine necessity for local entities and reasons why
- Differentiate between what must be invoiced through local entities vs offshore entities
- Ensure required documentation in place to support cross-border payments
- Review transfer pricing model
  - Check with internal Tax on transfer pricing model if cash accumulation seems too fast, and address repatriation issues or opportunities
  - Explore if invoices can be billed using an offshore legal entity (remote but worth asking)

Company Finance & Treasury Model

Lastly, determining the company's capital structure will enable the Treasurer to better:

- Capitalize local entities using intercompany loans to the extent possible, while considering thin-capitalization rules
  - This allows the repatriation of cash via the repayment of intercompany loans
- Implement a cash forecasting process to better manage liquidity and funding risks
- Review long dated outstanding intercompany balances (e.g., loans, accounts payable, accounts receivable)

- Focus on liquidity structures and cash pooling optimization
  - Automate cash movements, where possible, via target balancing and multi-bank target balancing
- Shift currency exposure from the subsidiary to the cash pool header or In-house Bank legal entity
- Perform due diligence when considering entering a new market:
  - Capitalization rules
  - Country restrictions
  - Payment and receipt rules
  - Funding and repatriation limits
  - Foreign exchange and currency regulations
  - Local entity requirements
- Extract cash through dividends in a timely manner
  - Know distributable earnings and profits
  - Compute withholding tax on entire dividend amount
  - Review tax implications such as double taxation relief, tax credits, and tax leakage with tax professionals
  - Research statutory filing timeline and process to ensure central bank approval for dividend distribution

Conclusion

An effective discussion on this topic takes a broad view of a company's business, treasury, and finance models rather than delving into a specific country or countries.

The ability of a company to navigate through countries with varying restrictions will likely be contingent on a few actions such as assessing capital structure, implementing or improving cash forecasting, optimizing or automating cash movements to a centralized cash pool, or ensuring a timely settlement of intercompany transfer pricing and dividends.

At this point, the discussion should then move to specific countries.

In summary, Treasurers should focus on what they can control versus what they can't and measure themselves accordingly.

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2293594 06/24