What is intercompany netting?

> Intercompany netting is an arrangement among subsidiaries in a corporate group where each subsidiary makes payments to, or receives payment from, a clearing house (Netting Center) for net obligations due from other subsidiaries in the group. This procedure is used to reduce credit/settlement risk. Also known as multilateral netting, netting and multilateral settlement.

A very simple concept but one that has tremendous benefits for a corporate group or body.

Multilateral Netting sums and converts each entity's transactions (payments) into a single local-currency amount to pay to or receive from the netting center. By doing so it reduces the cost of making payments and brings structure and discipline to intercompany (see benefits of netting).

For more information on different ways to run multilateral netting please click here.

What problems does multilateral netting solve?

The diagrams below illustrate the differences between a corporate not running netting and a corporate running netting.

INTERCOMPANY FLOWS FOR A CORPORATE NOT RUNNING MULTILATERAL NETTING

Problems

- Small / numerous / costly FX deals at subsidiaries
- High bank charges
- Uncertainty on the payment date
- Numerous payments during month
- No visibility over payments
- Difficult / costly to hedge
- More reconciliation work
- More reminders
- More administration
- Big mismatch on Intercompany bookings and therefore
- Problems with Intercompany Reconciliation (wrong P/L and balance sheet)

INTERCOMPANY FLOWS AFTER IMPLEMENTING MULTILATERAL NETTING

Quantifiable Benefits

- Payments costs are reduced because fewer payments are made
- Float. Concentration of payments and reduction in number of banks used leads to a reduction in float
- FX. Centralised and Netted off. Remaining FX is aggregated to larger volumes at better rates

Non Quantifiable Benefits

- Simplified payment procedures across group
- Brings structure and discipline to Intercompany
- Visibility of Intercompany across group

How Does Intercompany Netting Work?

- A multilateral netting or multilateral settlement system is a software application normally browser based.
- Subsidiaries, netting center, shared service centers, accounting can all be users of the system.
- Normally the subsidiaries input into the system either what they are going to pay or what they would like to receive.
- Normally run monthly, with cut offs (structure).
- Normally settled through a central hub (netting center) that fixes rates and deals all FX centrally.
- The system nets all transactions to one amount per sub in local currency.
- The system creates / initiates payments either physical to bank, cashless to In-House Bank (IHB) or both.
- No more bilateral payments in the group for most countries (please see

multilateral netting regulations and bilateral settlement for further information).