Europe has long been a prime market and trading partner for many U.S.-based companies. Several European economies are growing individually and collectively, creating new opportunities. Companies doing business in Europe need to stay on top of the constantly changing political, economic and regulatory landscape.
Whether you are just selling into or are building out operations on the ground, here are 10 issues to keep in mind when planning or doing business in Europe.

1. NEGATIVE INTEREST RATE ENVIRONMENT

Negative interest rates are prevalent across the Eurozone, Switzerland, Sweden and Denmark and do not appear to be moving in the short term.¹ As a result, most banks are now passing fees on to clients that hold balances in these currencies. Clients are being asked to move non-operational funds out of the bank or are being given a certain threshold that they must adhere to. In response, clients are finding uses for their excess cash. In a recent survey of EU-based companies, a large percent of CFOs are using these funds to expand their product lines, enter new markets, or acquire businesses. In other words, they are spending the cash.

Other companies have employed more aggressive strategies for managing their excess cash. Some have looked at intercompany lending and paying down debt as a use for the cash (such as paying down invoices from other entities). Some companies are building in-house banks or moving cash to other currencies or even back to the U.S. to mitigate the risk of having excess funds in weakening banks across certain countries in Europe. Companies are also considering the recent U.S. tax changes when determining how much cash to keep overseas.

It’s become increasingly important to understand where you have excess cash and integrating those balances into your information reporting dashboards. You should also examine your hedging strategies as there’s been a significant amount of fluctuation across European currencies in the past year.

2. BANKING STRUCTURE

European banks are far more dependent on short-term borrowing to fund their capital needs than U.S. banks. In some countries, the competition for deposits is greater than with comparative banks in the U.S.

Deposits and borrowing are the two main sources of funds for banks; where there is competition for deposits then banks need to rely on borrowing. As a result, many European banks have high loan-to-deposit ratios compared to what you might see with comparable U.S. banks.²
Since November 4, 2014, the ECB has been granted a supervisory role to monitor the financial stability of banks within the Eurozone via the Single Supervisory Mechanism (SSM), in accordance with the EU’s SSM Regulation No. 1024/2013. The ECB possesses the authority to conduct supervisory reviews, on-site inspections and investigations; grant/withdraw banking licenses; assess bank acquisitions; ensure compliance with EU prudential rules; and, if required, set higher capital requirements to counter financial risks.

Some of these regulatory actions may result in stifling growth in some European countries and curtail lending by some banks. This is an issue to monitor in terms of deciding where to operate and focus your resources in Europe.

3. METHODS OF PAYMENT
The use of checks in most European countries is almost nonexistent with the exception of a few countries (France and the U.K.). An instrument called a giro is still used in some countries, and even the use of cash is becoming less and less popular. Therefore, lockbox offerings in Europe are not nearly as essential as they are in the U.S.

The use of electronic payment systems in the U.K. and the rest of Europe is more common and there are generally more controls in place to protect the senders. This is in contrast to some well-publicized issues that have emerged in the U.S. in recent years.

Payment platforms have evolved across Europe and the U.K., much more quickly than in the U.S. in recent years. Platforms such as SEPA (Single Euro Payments Area), SEPA Inst and Faster Payments (U.K.) have facilitated faster and cheaper in-country and cross-border payments. SEPA payments are a fraction of the cost of wires and allow for one streamlined format across the EU.

Overall, the impact has been very positive, but an area of concern for U.S. companies will be the impact of the U.K.’s exit from the European Union (Brexit) and what impact this might have on their access to SEPA and other systems.

Brexit may impact the cost of payments and potential access to the entire scheme. Negotiations are in process and will likely be determined later this year.

4. NON-RESIDENT ACCOUNTS
It has become increasingly difficult to open non-resident accounts (non-resident meaning that the company does not have an entity set up within that particular country but still may need an account at a bank within that country). Amplified “know your customer requirements” across the world have increased the compliance costs to banks when onboarding clients. Companies without employees on the ground are often deemed as too difficult to work with in terms of verifying the identities of corporate representatives and, therefore, many banks are closing their doors to these businesses.

If this situation sounds like your organization, please contact your representative to understand how PNC can help.
5. CAPITAL ACCOUNTS
Some countries in the EU require the establishment of a capital account and a minimum subscribed capital injection in order to set up a European entity. This process precedes the opening of a current account or demand deposit account (DDA) in the U.S. Each country may have different requirements and capital injection thresholds based on the type of entity a company is setting up. Companies should work with legal counsel to set up these entities, and PNC can potentially offer assistance through our Gateway Direct referral program with European partner banks.

6. IN-COUNTRY ACCOUNTS REQUIRED FOR TAX PURPOSES
Value added tax (VAT) can be refunded for both non-resident and resident companies in Europe. Depending on the business structure, some countries, such as the U.K. and Italy, require a local in-country account in order to receive these refunds.

The European Payments Council put out a report in November of 2017 regarding IBAN discrimination for VAT purposes within the EU. This would apply to companies that are being required by certain tax bodies to set up in-country accounts in Europe where they are trying to pay VATs, which is not allowed. The EPC regulation states that a client may use a SEPA IBAN in any one of the SEPA-compliant countries to make and receive these payments. An example would be when a company maintains an account in the Netherlands but is also being asked to open an account in Germany for VAT purposes.

7. LIQUIDITY MANAGEMENT
Cash pooling is a practice that allows corporations to manage their global liquidity with lower costs across various business entities that fall under the corporate umbrella. This is an increasingly common structure for many multinational corporations. They structure their cash arrangements among subsidiaries to allow the cash deficits of one entity to be offset by the cash surpluses of another. This can simplify cash and liquidity management and reduce overall banking fees.

One popular form of cash pooling, called notional pooling, is very popular in many European countries. Notional pooling allows the offsetting of interest income and expense that results from the varying cash positions of each subsidiary or entity held in separate bank accounts within the same bank. Each entity participating in the pool maintains its own accounts.

The bank creates a “paper” or notional position from all of the participant accounts, resulting in a consolidated cash position on which interest is paid or charged.

Due to the implementation of Basel III regulations within Europe, many banks have determined that offering this product and adhering to the Basel capital requirements is too costly. Companies operating across Europe in single or multiple currencies should speak to their financial institution about the benefits of physical or notional cash pooling.

8. OVERDRAFT LINES
Overdraft facilities are frequently used in Europe as a way of financing working capital. While bank loans are still used as well, the use of overdrafts is less common in the United States.

In 2017, credit lines, including bank overdraft credit lines, were the most common form of financing used by European SMEs (small and medium enterprises).

Overdraft lines of credit can be expensive for your European subsidiaries or business partners and may become problematic if profitability in these entities starts to deteriorate. It is important to understand your subsidiaries’ financing needs and put policies into place to clarify your borrowing requirements.

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9. REGULATORY CHANGES

There are several regulatory changes to be aware of when doing business in Europe, including:

**Ringfencing in the U.K.**

This refers to the structural separation of the retail and commercial deposit-taking side of the banks from the riskier activities that may be undertaken by that institution.

In order to comply with the ringfencing rules, some banks and other depository institutions may have to reorganize their structure and perhaps some of their banking functions. This may impact an arrangement that your firm has in place and may result in less access to funding and services and/or the need to switch banks.

**Payment Services Directive PSD2**

PSD2 is a revised version of the Payment Services Directive that was issued in January of 2018. The original version was adopted in 2007 and was a foundation for the SEPA payment system.

PSD2 includes several enhancements, including:

- Removes barriers to entry to promote new entrants and competition
- Increases system security, including better customer authentication

• Reaches beyond the EU.
• Includes a legal requirement to provide refunds for bad transactions and a ban on surcharges for transactions.
• Caps liability for unauthorized payments.

It is incumbent upon companies affected by this and related payment systems to ensure their European partners and subsidiaries, as well as their bank, are up to speed on these enhancements.

**General Data Protection Regulation (GDPR).**

All banks and businesses operating in the EU, including those in the U.K., will have to comply with new rules surrounding data security.

To quickly summarize: Article 3 of the GDPR says that if you collect personal data or behavioral information from someone in an EU country, your company is subject to the requirements of the GDPR. The law only applies if the data subjects (as the GDPR refers to consumers) are in the EU when the data is collected.

The financial transaction does not have to take place for the extended scope of the law to kick in. If the organization just collects “personal data” — what we in the U.S. call personally identifiable information (PII) — as part of a marketing survey, then the data would have to be protected by GDPR requirements.

A major change made by the GDPR is the territorial scope of the new law. The GDPR replaces the 1995 EU Data Protection Directive, which generally did not regulate businesses based outside the EU. Now, even if a U.S.-based business has no employees or offices within the boundaries of the EU, the GDPR may still apply.

Under Article 3 of the GDPR, your company is subject to the new law if it processes personal data of an individual residing in the EU when the data is accessed. This is the case when the processing relates to the offering of goods or services or the monitoring of behavior that takes place in the EU.

Enforcement of the new GDPR rules commenced on May 25, 2018, and it is important to ensure that you and your banking partners are in compliance.
Markets in Financial Instruments Directive MiFID II

The first version of MiFID became effective in 2007. These rules include provisions requiring customer identification and categorization requirements, client order handling rules, pre- and post-trade order transparency requirements, and requirements for investment firms to help ensure that clients receive best execution on all trades.

MiFID II focuses on harmonized regulation of trading venues and processes throughout the EU. Improved and standardized governance and processes were a focus of this update that went into effect in January of 2018.

10. BREXIT IMPACTS

Since the Brexit vote in the United Kingdom in June 2016, there has been an air of uncertainty about what this means in general, as well as specifically for U.S. companies doing business in Europe.

Currently, the U.K. is in negotiations with the rest of the European Union regarding the terms of the U.K.’s exit from the organization, and they will likely include an extension to the two-year negotiation period ending March 29, 2019. While the impact upon U.S.-based companies doing business with the U.K. and the rest of Europe is still to be determined, here are some areas that your company should be investigating and monitoring:16

• The impact on currency markets and hedging. Any impact on the British pound relative to the euro and other currencies could also extend to the U.S. dollar. Currency fluctuations do not happen in isolation, so this is a situation to monitor. Your company may need to change its hedging and even its payment strategies going forward.

• The location of any of your employees between the U.K. and other European Union countries should be evaluated as there will be changes in the ability of people to travel between the U.K. and the other European Union countries.

Depending upon the final version of these restrictions, you may need to consider moving employees based in Europe from their current location.

• Supply chain. Many companies move source products from the U.K. and the EU or move products to be finished in another European country. These cross-border movements may be costly with a potential new trade agreement going into place. This may necessitate changes in your operations and perhaps even the locations in which you do business within the U.K. or the rest of the European Union countries.

PNC has years of experience and significant expertise in aiding our clients doing business in Europe. We collaborate with CFOs and senior management to ensure that all aspects of your banking and financial operations run smoothly, allowing your company to focus on expanding your core business and taking advantage of new market opportunities. Contact your Relationship Manager or visit pnc.com/international to learn more.

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