



## cash management

BRAZIL

# Hot stuff



THE BRAZILIAN FINANCIAL MARKET OFFERS TREASURERS A WIDE RANGE OF PRODUCTS FOR CORPORATE CASH, WHICH IS IMPORTANT, AS STRONG GROWTH MEANS CORPORATES ARE HOLDING MORE CASH. **FLORENT MICHEL** EXPLAINS THE OPTIONS.



**B**razil is experiencing an unprecedented economic boom. In the last five years international corporates have intensified their presence in every sector of the economy. The 10 largest multinationals in Brazil had a combined turnover of US\$105bn in 2009, a record for the region. According to IMF estimates, Brazilian GDP in 2010 should equal that of the UK at around US\$2.1 trillion. While GDP continued to grow at a fast pace in 2010, increasing by over 7.5%, the true financial turning point for the country happened in 2007 when it obtained its first investment-grade rating. This clearly boosted an already dynamic economic drive, enabling the country to access attractive long-term international funding, with bond issues of up to 32 years. And

with 8.5bn km<sup>2</sup> of land Brazil is a very big country, nearly as big as the US (9.8bn km<sup>2</sup>), and has a population of more than 200 million.

Brazil is still rated BBB-, with strong potential for an upgrade move in 2011. In parallel the equity market has exploded and the local stock exchange Bovespa (Bolsa de Valores de São Paulo), with a market cap of US\$1.5 trillion (as at December 2010), is one of the biggest in the world, compared with Deutsche Borse at US\$1 trillion or the London Stock Exchange at US\$3.6 trillion.

Brazilian banks are enhancing their credit standing although they are still far from competing with the global players in terms of size and global reach. Banco do Brasil, Brazil's largest bank, had total assets of US\$362bn as at December 2010, while HSBC, for example, has around US\$2.4 trillion. At US\$740bn, the total combined deposits of the 10 largest Brazilian banks don't equal those of a BNP Paribas alone (US\$780bn).

On paper, Brazil is therefore an economy which has a phenomenal development potential. This being said, there are still grey areas that will need to be fixed. Problems include a lack of infrastructure, a scarcity of qualified workers and executives, exploding private debt in the form of consumer loans, an inflation threat, and a level of poverty that remains high (10% of the population controls 42% of the wealth).

**IMPROVING BUT NOT BY MUCH** Over recent years the daily life of Brazilian treasurers has improved although not by much. On the one hand, the country has continued to develop fantastic technological ingenuity to put together world-class cash management tools. True state of the art technology is there to move funds efficiently, to make payments and placements, and to speed up collection processes. Straight-through processing is a reality in areas as complex as trade finance and derivatives. On the other hand, the tax system remains a nightmare, foreign exchange regulation is still hefty (no US dollar local accounts are permitted), and central bank and regulatory reporting is burdensome, with costly dedicated back offices needed to manage a jungle of papers.

**SO WHAT ARE THE CASH MANAGEMENT ISSUES IN BRAZIL?** Corporates in Brazil are not expecting fundamental changes in the ways of managing their treasury, cash management and financing in the near future. They will have to continue to overcome a slew of administrative hurdles, and



tax complexity and reporting burdens. The 0.38% IOF (Imposto Sobre Operações Financeiras) tax on financial transactions is set to remain.

A more recent factor is the sudden increase in wages and salaries in the financial sector, which should encourage multinational corporates to rethink their regional strategy in terms of shared service centres and outsourcing.

Salaries in the financial sector are today as high as if not higher than in Europe or the US.

On a more positive note, corporates should continue to benefit from continuous upgrades of what are already state of the art treasury systems and processes as they carry on investing in IT. Financial and tax authorities and banks have embarked on a series of projects to improve processes and limit reporting constraints. However, it will be some time before the treasury environment is as flexible as in Mexico, Peru, Chile or Uruguay, for example.

**OPTIMISING LIQUIDITY MANAGEMENT** There are a number of ways to improve liquidity management. Because corporates cannot hold US dollar domestic accounts (only a few exporting companies can hold US dollar accounts offshore), the focus is on optimising liquidity of accounts held in the Brazilian real (R\$).

First, treasurers should aim to concentrate liquidity: the largest banks are equipped with zero balance account (ZBA) capabilities, which are backed by an efficient clearing system. Subsidiaries within the same legal entity can pool their local currency on a daily basis into a concentration account. However, notional pooling is not possible.

Payments in Brazil are truly advanced, with more than 85% of payment transactions being made by transfers; cheques account for only 12% of the total.

The instrument for high-value payments is called TEDs (transferências eletrônicas disponíveis) and clearing is done in 45 minutes. The one for low-value payment is called DOCs (documentos de transferência de crédito), and credit at the bank is same-day or day+1, depending on the bank. Cheques are cleared in a specific clearing house called COMPE (Centralizadora da Compensação de Cheques) and are credited day+1. Boletos are also credited day+1.

Boletos are bills issued by a seller to a buyer. They are the most commonly used business-to-business payment instrument in Brazil, are negotiable at any bank counter and can be processed electronically. Since 2009, an electronic exchange platform for boletos, called DDA (Débito Direto Autorizado), allows for a full electronic trading of the instrument. DDA allows corporates to settle boletos even more rapidly and get financing upfront as payments are confirmed earlier. Companies with large pool of receivables (more than R\$150m per year) can also use a Brazilian securitisation structure called FIDC (Fundo de Investimento em Direitos Creditórios) to optimise their cash inflows and to

## GIVEN THE COUNTRY'S IMPRESSIVE ECONOMIC GROWTH MANY BRAZILIAN COMPANIES HAVE BECOME EVEN MORE CASH-RICH AND HAVE TO MANAGE MUCH MORE SIGNIFICANT CASH-POSITIVE BALANCES.

limit IOF payments. Net-net, the overall system is very efficient and should enable any treasurer to optimise cash management. At the same time treasury systems providers are present on the market and are offering online treasury management platforms in Portuguese.

### WHAT TO DO WITH MORE CASH?

Given the country's impressive economic growth, many Brazilian companies have become even more cash-rich and now have to manage much more significant cash-positive balances. This includes keeping a sufficient operating cash cushion, optimising short and medium-term cash balances, and efficiently managing dividend payouts and repatriation. Nor should it be forgotten that Brazil is a very high interest rate environment. With the Central Bank benchmark rate (SELIC, or Sistema Especial de Liquidação e Custódia) standing at 11.75% in March 2011, a week or a month of float is clearly worth something.

The Brazilian asset management market is very sophisticated. Banks and intermediaries have created a variety of plain vanilla, hybrid and derivative placement products. The reference rate for placements is called CDI (certificado de depósito interbancário), which is close to the official SELIC rate. Before looking at what is available in the market, the first issue to look at is tax (which is the preliminary question for any financial decision in Brazil). The three main classes are:

- short-term (less than 30 days) money market or bank placements, which are IOF-taxed at 0.38%;
- medium and long-term placements, which are generally not IOF-taxed but can be taxed for certain types of instrument; and
- financial capital gains, which are taxed in the same way as ordinary income.

Treasurers have a choice between ranges of placement products, and banks offer custom-made products which are generally linked to, or deriving from the following:

- government bonds;
- banks' certificate of deposits and repos; and
- other instruments.

The Brazilian financial market offers treasurers a wide range of products for corporate cash. The risk aspect is very important. All products have different credit risk profiles, but it is also important to watch liquidity, legal and execution risks. Especially in an economic environment where "overheating" is a word we keep on hearing more and more.

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