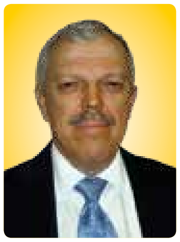
THIS MONTH

A FRESH PERSPECTIVE

My name is Steve Baseby and I have joined the ACT's policy and technical team from the UK utility industry. This month, we are looking at negative deposit rates. Should we accept that cash rates may remain low and focus on how to manage them instead? Meanwhile, Greece and the euro remain works in progress and I've included some comment on the shrinking options for both parties. In addition, changes to money market funds could affect treasurers.



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{ IN DEPTH }

WHAT'S THE COST OF WAREHOUSING YOUR CASH?

Low central bank short-term interest rates have continued (see *The Treasurer*, December 2014/January 2015, page 11). They are now exacerbated in the eurozone where the European Central Bank has commenced quantitative easing (QE). With QE policies, central banks create cash and depress interest rates in order to push for spending over saving. Euro bank deposit interest rates have started to move to negative territory, joining Swiss bank deposit rates.

Corporate treasurers tend to hold more cash now than they did prior to 2008, when the main concern was the working capital float. Now, we pre-borrow because we lack confidence that traditional sources will be able to deliver new money when we need them to. Also, there is a reduced appetite for uncommitted lending at eurozone banks as they look to comply with Capital Requirements Directive (CRD IV). As a result, treasurers have to manage an increased cost of carry, which was near immaterial as recently as 2007, but is now several per cent for even the largest businesses.

There are other knock-on effects. For example, treasurers of very large enterprises may also need to manage the effect of cash-collateralised derivatives where the International Swaps and Derivatives Association has provided for simplified management through the Collateral Agreement Negative Interest Protocol since May 2014 (see www2.isda.org/functional-areas/protocol-management/protocol/18).

Net interest cover ratios in loan agreements may need to be reassessed, since they may increase beyond the forecast levels when the agreements were executed and the cost of carry was too low to distort the ratio.

How far down interest rates can go, and for how long, leads us to the question of when Western economies will recover so that normal cash demand is resumed and interest rates rise. Not that we should expect the low spreads to return – CRD IV should have put paid to that in the EU.

Traditional cash management for a corporate had become pooling, bank deposits and money market funds (MMFs), with one eye on yield and the other on counterparty exposure. Changes are already under way in the MMF industry (see opposite). CRD IV and its equivalent regulations outside of the EU may impact on the efficiency of cross-border pooling now that the cash-holding bank may pay for its liquidity reserve, while the cash-lending bank must charge for credit risk.

Some very large corporates have started using repos with insurers and pension funds to disintermediate banks and enhance deposit yield, but these may become less attractive.

The proposed EU Securities Financing Transactions Regulation may lead to reporting to central counterparty clearing houses and annual report and accounts disclosure as regulators turn their attention to shadow banking.

This may be the time for lateral thinking. Would a supplier give a discount for quicker payment? Would the pension fund appreciate an earlier contribution, providing that it does not shift the investment problem to the fund itself? Would the investors like an earlier dividend? There is plenty to consider.

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The immediate question is: should Greece stay or go away? 'Go' is not a desirable option for either the EU or Greece

{ INTERNATIONAL }

IMPLICATIONS OF A GREEK EXIT

We considered the breakdown of the eurozone in December 2011 (see www.treasurers.org/contingencyplanning/euro), but the same problems remain today.

The immediate question is: should Greece stay or go away? 'Go' is not a desirable option for either the EU or Greece, although skilled or wealthy Greeks can perhaps take advantage of the loose borders within the EU, and family ties as far away as Australia.

Any solution must keep money flowing into Greece in order to cover structural deficits, stop it leaking out (although any barrier is against EU principles), and avoid suggesting that there are soft options to manage the piles of cheap debt that countries have accumulated since 2000. It must also allow for the fact that economically weaker EU members have their own versions of Greek's Syriza party to manage.

Reopening the centuries-old debate over Russian access to the Mediterranean and Balkan borders is dangerous. If Greece left the eurozone, it would be doomed to prolonged economic disaster, with an ageing population, a diet rich in petrocarbons and high youth unemployment (a problem that afflicts other Western economies), unless a foreign saviour arrives.

For treasurers, a 'stay' probably entails some barriers to getting cash out of the country, but keeping what value is left largely intact. A 'go' means writing off the assets that the business has left in the country and hoping that cunning lawyers do not enforce the liabilities. But do check your cross-default clauses if you plan to walk away.

NEW ON THE WEB

View the following technical updates and policy submissions at www.treasurers.org/technical and www.treasurers.org/events/webinars

ACT response to ESMA call for evidence on credit ratings

ACT past webinars:

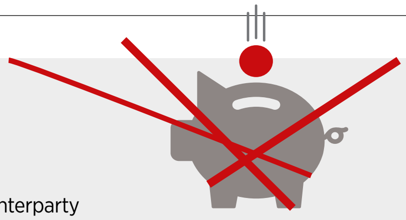
Hedging FX is changing

Exploring the impact of free trade reform in China

A reminder of *The Treasurer's Wiki*: www.treasurers.org/wiki

{ WATCH THIS SPACE }

MMFs ARE EVOLVING



Money market funds (MMFs) have been a simple way for treasurers to diversify their counterparty risk and increase yield over deposits with their relationship banks.

The traditional constant net asset valuation fund assumed that the fund value stayed constant and cash remained available. Some funds enabled same-day withdrawal, although some could restrict withdrawals in times of tight liquidity. Their main risk was counterparty exposure in times of stress, such as when the sterling-denominated funds began to concentrate investments in eurozone banks following the 2008 crisis.

New regulation for MMFs in the EU is proceeding towards the adoption of variable net asset value (VNAV) funds in order to diminish the risk of them becoming 'too big to fail' in a new liquidity crisis. VNAV funds recognise the moving valuation of short-term investments and are intended to require daily valuation, which could slow settlement.

The ACT will monitor developments. Meanwhile, treasurers need to consider how these changes could impact on their cash management processes, and on their treasury policies, which may not enable investment in products that explicitly put capital at risk.

{ TECHNICAL ROUND-UP }

ESMA, EMIR AND WHT EXEMPTION

The European Securities and Markets Authority (ESMA) has updated its Q&A document for the European Market Infrastructure Regulation (EMIR). This includes questions on the status of entities not established in the EU and return of excess collateral by central counterparties when a client opts for individual segregated accounts. For more, see http://tinyurl.com/mtnaofj

ESMA has also launched a project to provide a single access point to trade repositories data under EMIR. According to ESMA, this will provide it and the 27 national competent authorities with access – through a single platform – to the 300 million weekly reports on derivatives contracts that are received from 5,000 different counterparties across the EU trade repositories. The project is expected to go live in 2016.

Revised UK legislation for the withholding tax exemption for private placements has been published. The exemption now includes loans as well as bonds, and does away with the requirement for the security to have a minimum three-year term. It can be found in Clause 23 of the Finance Act 2015. See http://tinyurl.com/pm8yako

FX market committees from eight major central banks have issued a revised *Global Preamble: Codes of Best Market Practice and Shared Global Principles*. This includes more detailed, globally harmonised guidance than the original version, published in 2013. See http://tinyurl.com/py5639t

The People's Bank of China is soon to launch a bank deposit insurance scheme, insuring deposits of up to CNY 500,000 (£55,000). The scheme is seen as a step towards deregulation of domestic interest rates, which could lead to the removal of the cap on bank deposit rates.