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The Treasurer

THE MAGAZINE OF THE ASSOCIATION OF CORPORATE TREASURERS ◆ NOVEMBER 2016

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Rando Bruns, head of group treasury at Merck, on why skills and culture matter

The Treasurer November 2016 The Magazine of The Association of Corporate Treasurers www.treasurers.org/thetreasurer

ACT
LEADING TREASURY PROFESSIONALS

Editor's letter

Arguments that the impact of Brexit could feasibly be deferred until a yet-to-be-determined date when the UK government would trigger Article 50 are rapidly falling away.

With the pound declining to record lows against trade-weighted averages last month, concerns are mounting around what the next few years might bring, with more than a handful of corporates already suggesting profits will be affected. Suddenly, the comfortably far-off effects of exiting the EU aren't looking quite so comfortably far off.

Currency risks have edged up the agenda, and treasurers will be revisiting hedging arrangements. Some will have more flexibility than others, but sadly, the global scene offers little in the way of respite or reassurance. In just a few days, we will learn the outcome of the US election. Forecasters have been leaning increasingly towards a Clinton win, but the populist element and the profound sense of polarisation within the electorate of this unusually bile-filled election can't be totally disregarded. On page 18, commentator Roland Hinterkoerner picks over Donald Trump's spending intentions and weighs up the implications of an infrastructure spending spree fuelled by Treasury bonds.

Into this mix, we're seeing the advances of some large-scale transactions. As I write, telecoms giant AT&T is in talks with Time Warner for what would amount to an $85bn tie-up, while British American Tobacco aims to buy back into the US tobacco market with a $47bn offer for Reynolds American, in which it already holds a 42% stake.

The case for tobacco mergers and telecoms-content tie-ups resoundingly made, is the stage set for a wave of deals across other sectors? Consolidation may prove a decent strategy for shoring up market presence and spreading risk.

In our profile this month we talk to Rando Bruns, head of group treasury at German life sciences group Merck, who knows a thing or three about acquisition funding. Merck's purchase of Sigma-Aldrich, finalised in 2015, was a bold move, 100% debt-financed. Bruns explains the mechanics of the Sigma-Aldrich and other deals on page 20, as well as describing how he managed Merck's relationship banks over the course of the deal, and the role that treasury can play in post-transaction integration.

On page 24, Sally Percy explores the role that the ACT and treasury professionals have played on a public stage when they seek to shape and influence regulatory change, and on page 34, we look also at the opening up of Iran in a post-sanctions era.

I hope you enjoy the issue.

Liz Loxton

editor@treasurers.org
Follow us on Twitter @thetreasurermag

THIS MONTH'S CONTRIBUTORS

Roland Hinterkoerner is a former banker and founder of consulting and online financial publishing business Expertise Asia. He is a commentator on economic and geopolitical issues. He blogs at @ExpertiseAsia and his piece on Donald Trump is on **page 18**

Farah Khalique is a freelance business and finance journalist with a specialism in FX and corporate governance issues. Her article on the need for ever-greater transparency within corporate life, and the demands that exerts on treasurers, is on **page 30**

Semih Ozkan is an ACT student and a transaction banking professional in an international bank. A long-time observer of developments in the Middle East, his article on conditions in Iran as it enters a new post-sanctions era can be found on **page 34**

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What do you think of this issue of *The Treasurer*? Please write to **editor@treasurers.org** or tweet **@thetreasurermag**

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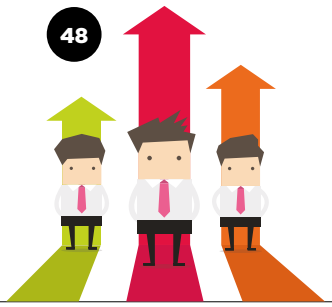
Rando Bruns, head of group treasury at Merck



Agenda

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{ CONTEXT OF TREASURY }

CFOs TURN TO TREASURERS FOR STRATEGY INPUT

Regulatory compliance, economic uncertainty and the interest rate outlook are among the strategic issues where finance heads increasingly turn to their treasury counterparts, according to a white paper from the Economist Intelligence Unit (EIU).

The study, *Managing Risk in Challenging Economic Times*, which was published last month, sets out the spectrum of issues on which CFOs consult treasurers. Macroeconomic, regulatory and technological challenges are not just reshaping treasury's outlook, it concluded, but they are also changing the way the treasury function interacts with the rest of the organisation.

Compiled from a survey of 150 senior treasurers and 150 CFOs worldwide, the EIU's white paper confirms that treasury's partnership with the rest of the business has strengthened.

Uncertainty about economic growth is by far the top concern that treasurers around the world are dealing with at present, while low – or even negative – interest rates are triggering significant policy changes in the area of cash management.

Meanwhile, compliance and other regulatory matters are taking their toll on treasury resources, with respondents saying they already spend a lot of time on compliance.

Almost 80% expect their compliance workloads to remain as high as they are, or even to increase. "This avalanche of new regulatory requirements has spawned a palpable sense of frustration among many treasurers," the report's authors said, "especially with regulation that is seen as creating high burdens without delivering any tangible benefits."

In addition, "Several [treasurers] also worry that the higher compliance costs, along with higher capital ratios for financial institutions, could cause banks to become more selective.

"Regulation is thus not just seen as a nuisance, but also as a potential threat to bank relationships," they concluded.

{ CONTEXT OF TREASURY }

Businesses square up to rising costs as pound falls to historic low

Last month's fall in the value of the pound caught a range of businesses off guard.

Sterling's post-referendum fall in value halted over the summer months only to begin again, against growing political signals that the UK will execute a 'hard exit' from the EU and the single market.

Sterling hit a historic low in early October against a trade-weighted basket of currencies. The pound has dropped by more than 15% against the euro since the referendum.

Businesses that pay suppliers with a weakened pound are finding themselves increasingly caught by the dilemma.

Sports Direct International, for instance, reported that the flash crash in the pound could cause earnings at the sports retailer to fall by as much as £35m.

Other businesses affected by currency movements included UK-based airline easyJet, which put the cost of the declining pound at around £90m for the year ending 16 September. Irish budget airline Ryanair cut its profit forecast by 5% ahead of its full-year results, citing the drop in the pound as the cause.

According to research from East & Partners, 80% of the UK's biggest companies put hedges in place ahead of the June vote on the UK's EU membership. Some 22% of SMEs also put currency protection in place in the run-up to the vote.

However, for those companies with arrangements due to expire, questions around passing increased costs onto their customer base or facing diminishing margins are heightened.

SHUTTERSTOCK

WORDS

"There will be a period of a couple of years, or perhaps even longer, when businesses are uncertain about the final state of our relationship with the EU. During that period, we need to support the economy to make sure that consumer confidence remains."

UK chancellor Philip Hammond (pictured above) signals a temporary halt to austerity in an effort to bolster the economy as the country prepares for Brexit in 2019.

SOURCE: *EVENING STANDARD*, 3 OCTOBER 2016

{ KEY FINDINGS FROM THE *DELOITTE CFO SURVEY* FOR Q3 2016 }

88% of respondents rate the level of external economic and financial uncertainty as above normal

71% expect the Bank of England base rate to remain at or below 0.25% in a year's time

47% see reducing costs in their business as a strong priority

42% rate increasing cash flow as similarly important

39% also see introducing new products or services, or expanding into new markets as a top priority

{ CONTEXT OF TREASURY }

UK CFOs remain cautious in the wake of Brexit, survey finds

The latest quarterly survey of UK CFOs from Deloitte has found that Brexit and economic risks continue to exercise finance heads, with investment and hiring spend expected to decline over the next year.

In the months since the UK voted to leave the EU, equity markets have rallied and a raft of UK and global economic indicators have strengthened. However, CFOs surveyed by the accountancy firm said they continued to see significant risk in the current business environment.

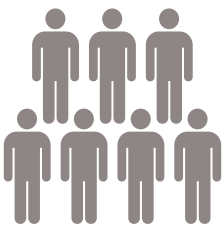
"The animal spirits of the corporate sector took a battering in the wake of the referendum and, three months on, Brexit continues to loom large for the UK corporate sector," said Ian Stewart, Deloitte's chief economist.

Brexit-related risks topped the list of concerns of those surveyed, with a corresponding impact on corporate risk taking. Some 18% of respondents said now was a good time to take risk onto the balance sheet, up from 8% in the survey taken immediate after the referendum. CFOs who took part also said they expected to see their spending on investments and on hiring decline over the next three years as a result of Brexit.

CFOs had a continued focus on cost reduction and better cash-flow management, with 47% prioritising reducing costs and 42% putting increased cash flow as their top concerns. However, the percentage of CFOs who rate introducing new products or services, or expanding into new markets as a strong priority has risen from 27% to 39% since the previous survey was published just after the referendum.

$152trn – the size of world debt, which stands at more than twice the size of the global economy, according to the International Monetary Fund

21,500 – the number of Brits who applied for Irish passports over the summer months, double the number of applicants for the same period the previous year



£285m – the amount of credit card debt written off in Q2 2016 in the UK, according to The Money Charity

100 per week – the number of passenger flights between the UK and China, following a deal between the two countries aimed at encouraging trade

£250,000 – the cash prize offered by Lord Wolfson, CEO of Next, for the best suggestion on how to ease congestion on the UK's overcrowded road network

73% – the tariff agreed by the EU on Chinese steel imports to protect European manufacturers

{ CORPORATE FINANCIAL MANAGEMENT }

UK rides high in poll for inbound M&A investment

The UK has become the second most popular country for inbound M&A activity, according to a poll from law firm Allen & Overy.

The UK overtook Switzerland in the rankings for the third quarter of this year, as the fall in the value of the pound made UK assets more attractive to international buyers, according to the survey. Allen & Overy cited the takeover of Premier Farnell by US group Avnet Inc as evidence of the UK's newly strengthened position, after Avnet outbid Swiss group Daetwyler.

Overall, though, deal values have fallen 24% compared with this time last year. In fact, 2015 saw a record-breaking amount of large transactions, but all regions have seen a slowdown in deal activity this quarter. In the US, there has been a 32% fall in transaction values for Q3 2016 compared with the same period last year. China has seen a 26% fall and Western European deals have contracted in value by 18%.

The report's authors cited continued turbulence across the political and economic climate, including the long-term effects of Brexit, an unusually contentious US presidential race and concerns around commodity prices and faltering economic growth in emerging economies.

{ AROUND THE WORLD IN 30 DAYS }

SHENZHEN CONNECT, HOUSE OF LORDS, BRICS

Shenzhen and Hong Kong market tie-up

Four of Asia-Pacific's largest regulators have set the seal on a stock market tie-up to boost the flow of stock market activity between Hong Kong and Shenzhen, China. Set for launch later this month, Shenzhen-Hong Kong Stock Connect, or Shenzhen Connect, has been designed to bridge the territories through improved mutual market access, enabling investors to buy and sell eligible shares listed in both China and Hong Kong. The venture builds on work already established to bolster market cooperation between Hong Kong and China, via Shanghai Connect.

Shenzhen Stock Exchange chairman Wu Lijun said: "Shenzhen Connect is a major policy initiative by the Central Government to promote reform and opening up in the capital market."

House of Lords to scrutinise Brexit impact

The House of Lords' EU internal market subcommittee has launched an inquiry into the implications of Brexit for the UK's trade in services with the EU.

The committee has been hearing evidence from key service sectors, including professional business services, aviation and telecommunications, as well as experts on EU law and global economics, with the aim of determining the implications of different levels of market access the UK might negotiate with the EU. Key questions under consideration include which sectors are most significant to cross-border trade with the EU, and what kind of non-tariff barriers impact on trade.

The committee has separately urged that the UK parliament should be actively involved in scrutinising forthcoming negotiations, rather than after the fact, as proposed by the UK government.

House of Lords to investigate impact of Brexit

SHUTTERSTOCK

BRICS leaders bullish

Weighing against concerns in the West around a flight from globalisation, last month's BRICS summit reaffirmed the impact of emerging economies on the world stage, commentators argued.

The five heads of state from Brazil, Russia, India, China and South Africa met in Goa, India, for the eighth annual summit and spoke of the growing momentum of the group, while pledging to contribute to institutions such as the New Development Bank and the BRICS Contingent Reserve Arrangement as a means of improving financial safeguards.

Roberto Jaguaribe, president of the Brazilian Trade and Investment Promotion Agency, said there were two main aspects to the group's impact worldwide: the large number of developing countries in their respective region and the fact that BRICS countries themselves now represent 25% of the world's GDP.

THE STATS

{ KPMG LUXEMBOURG *TREASURY SURVEY 2016* KEY FINDINGS }

55% of respondents classified their treasury centre as a service centre

20% called it a cost centre

35% said their treasury policy was comprehensive, but in need of improvement or update

85% said treasury took a lead role on borrowing and bank relationship management

*The survey focused on companies with treasury activities in Luxembourg. The base was made up of corporates headquartered in Europe, Luxembourg and North America

{ TREASURY OPERATIONS }

DUBAI'S SHARIA-TRADE FINANCE BANK A WORLD FIRST

The United Arab Emirates (UAE) will soon be home to the first-ever international bank dedicated fully to Sharia-compliant trade finance products.

According to a statement from the Dubai Islamic Economy Development Centre (DIEDC) and pending regulatory approval, Emirates Trade Bank will offer integrated trade and commodity-financing solutions.

The bank will help Dubai meet its strategic goal of supporting the Islamic financial sector, while integrating investments towards a doubling of UAE trade flows by 2020.

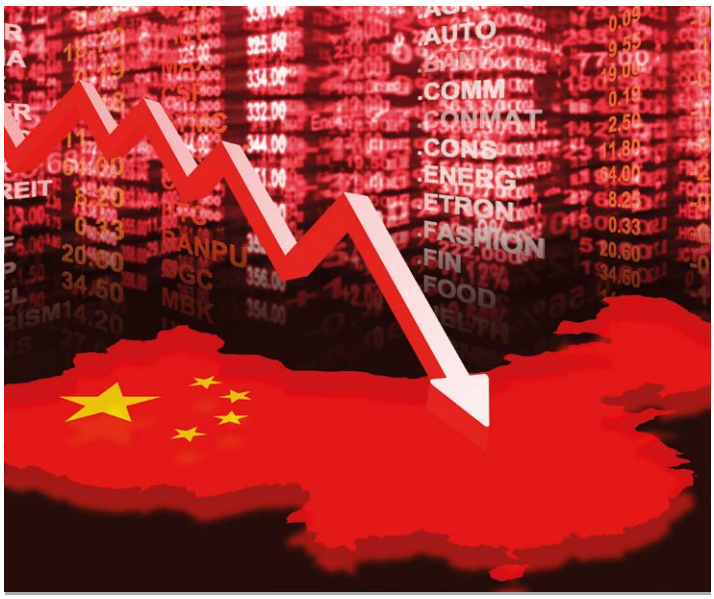
Sami Al Qamzi, DIEDC vice chairman and director general of Dubai Department of Economic Development, said: "The UAE in general, and Dubai in particular, are privileged to have a diversified, open and flexible economy capable of addressing international and regional challenges.

"Emirates Trade Bank is set to reap synergies from the strategic positioning and advanced technical and logistics infrastructure of Dubai, in its efforts to finance international trade and commodity flows – particularly through the UAE."

DIEDC added that it "will continue to support initiatives aimed at transforming Dubai into the capital of the Islamic economy.

"The UAE and the emirate of Dubai have always been the leaders and pioneers in the Islamic finance industry, with the establishment of the first Islamic bank in the world in the 1970s."

MAKING THE NEWS



China's growth slowdown prompts deep concerns

While official figures from China report a GDP of 6.7% for the third quarter, consistent with the pace of growth for Q1 and Q2 this year, cracks in the numbers are beginning to show, according to reports in *The New York Times* and elsewhere.

Some commentators are characterising the slowdown in headline growth rates as dramatic, sufficient to warrant major concern for central banks, investors and international corporates. Chief among their worries is China's burgeoning debt, which, if its current pace of growth continues, may bring China to the brink of a financial crisis comparable with the global crisis of 2008, with implications for the wider economic community.

Controversially, China seems to be pressing ahead with a scheme to allow companies to exchange debt for equity. Corporate debt currently stands at around $18 trillion.

Saudi's first bond issue finds favour

In a record amount for an emerging-market bond debut, Saudi Arabia raised $17.5bn in an international issue. The bonds, which were issued in five-, 10- and 30-year tranches, were greeted with enthusiastic demand and have been widely seen as a successful example of the kingdom's efforts to move away from an oil-led economy to a more diverse one.

The bond deal exceeds a $16.5bn issue in Argentina in April and comfortably eclipses the $9bn bond sold in Qatar in May, and proves that emerging-market debt is very much in favour. Another notable feature, according to a report in the *Financial Times*, was the fact that 30-year debt proved more popular than five- or 10-year debt, with $6.5bn of investors' cash attracted to the longer-tenor issue.

US banks' earnings rally

Q3 marked a return in fortunes for Bank of America, whose net profits rose to $5bn, its best quarterly result since 2008. While JPMorgan Chase and Citigroup saw lower net profits than Q3 last year ($6.3bn and $3.8bn respectively), all three banks reported stronger sales from bond trading. JPMorgan's results were helped by record profits in its commercial banking division, as well as strong trading activity. The bank reported an 8% YOY increase in revenues.

{ CONTEXT OF TREASURY }

HACKERS CLAIM NEW TERRITORY IN SUSTAINED DENIAL OF SERVICE ATTACK

Hackers demonstrated the effectiveness of a new method of cyberattack last month, disabling multiple websites when they targeted US domain name service provider Dyn and rendered key e-commerce inaccessible for hours at a time.

The cyberattack that targeted Dyn temporarily silenced key websites, including Twitter, Spotify, Netflix and news sites for the *Financial Times* and *The New York Times* in a so-called distributed denial-of-service (DDoS) attack.

Dyn provides a key service to some of the world's busiest websites, by monitoring and routing internet traffic. Its servers translate internet addresses that humans can read and remember into the IP addresses used by the internet. *The New York Times* reported that the attack used many thousands of internet-enabled devices, including cameras, baby monitors and home routers, infecting them with software that then flooded the service provider with traffic at the hackers' command.

The first attack hit the service for two hours and was followed by a second attack two hours later.

DDoS attacks have risen by 129% YOY, according to a report by Akamai, a web security company.

{ CONTEXT OF TREASURY }

GLOBAL USE OF RENMINBI CLIMBS

Global business use of the Chinese renminbi has climbed by 7% since 2015, with nearly a quarter of corporates now using the currency to do business with China, according to figures from HSBC.

Reduced FX risks and costs has emerged as the primary motivating force behind the growth.

However, only around two in five corporates surveyed by the bank said they were aware of opportunities afforded by China's Belt and Road initiative, with only 7% of those businesses that were aware of it working on a Belt and Road strategy.

Out of the companies developing strategies to participate in Belt and Road opportunities, European corporates led the way with 12% of 'aware' businesses seeking an early advantage. North American firms were next at 9%. In Asia-Pacific, just 6% of 'aware' firms are making strategic plans involving Belt and Road opportunities.

"Belt and Road projects are already presenting huge opportunities for companies that can help develop physical infrastructure," said Noel Quinn, chief executive of HSBC Commercial Banking. "But these are only the first steps. By boosting connectivity, Belt and Road will catalyse trade between more than 65 countries that are home to nearly two-thirds of the world's population. For any company seeking growth and new customers, that's an exciting proposition to explore."

Chinese enterprises invested $14.8bn on Belt and Road initiatives last year, on infrastructure projects that span 49 countries and cover railway programmes, logistics hubs and power generation. China Development Bank said it plans to contribute $895bn in project funding.

THIS MONTH

TRADE AGREEMENTS

Noises continue over Brexit: we now have a date for Article 50 notification; the rest of the EU has realised that the impact may not be as muted, or as benign, as expected. However, the world awaits elections in the US, France and Germany, with the risk that the Western economies move away from the macroeconomic policies prevalent for the past 60 years.

If you have views you'd like to share with the ACT policy and technical team on any subject or have your own submission you are willing to share, please email us at technical@treasurers.org

Steve Baseby is ACT associate policy and technical director
@BasebyStephen

{ IN DEPTH }

The end of globalisation?

The period post the 2008 financial crisis (FC) has been one of intense change as financial services regulation across the G20 nations will continue to be rolled out until the end of 2018 when the Basel III rules come into full effect.

Corporate treasurers have been impacted by these changes, often, we believe, unfairly because they were neither the cause of the FC, nor revealed any systemic risk during it. They have been drawn into complex reporting systems and must, on occasion, provide collateral – solutions that are designed to give warning that banks may be in trouble, and then to soften the blow. Banking capacity to the real economy has been reducing and becoming more expensive. At the margins, real-economy employers risk being classed as bank-like entities.

The benefit, hard as it may be at times to identify, has been that post-crisis regulation has a strong bias towards standardisation and an extension of the post-World War II globalisation that has been enhanced by the creation of the EU and the fall of the Iron Curtain.

However, is this about to go into reverse? The Brexit referendum revealed a significant electorate within the UK that wants borders re-established, physically and economically. Although Britons have long been harangued by their European neighbours for insisting on being different, perhaps they were just at the front of the train.

The US goes to the polls this month and whoever wins may find that the economically (and politically) disengaged have become the majority, with the resultant shift in policy that requires. The far right may win control in the French election in 2017 and seek the same physical barriers within the EU for which Britons voted. Finally, German elections are increasingly putting Chancellor Merkel's assertion that Germany could and should welcome refugees from outside of the EU under strain.

The return of protectionism

Back to Brexit, the principle concern for the financial services sector is that financial regulation may diverge so that not only passporting, but also equivalence (see *The Treasurer*, October 2016, page 11), may come under attack.

Divergent financial regulation may oblige financial service providers to fragment their businesses across countries with a resultant increase in cost, not only of administration, but also as a result of tailoring their services to domestic laws.

This risk may also apply to the non-financial sectors as national governments exhort their electorates to think domestically. At present, much of the real economy is enabled by the ease of moving goods and services across borders.

Divergent regulation in the real economy may result in the production of different goods for different countries. Manufacturers and service providers will be faced with the same conundrum as financial service providers: whether to withdraw to the most populous markets or fragment their product range to meet each market's demands.

For example, Japan Inc has been vocal in expressing its concerns about where all this change could lead and in September issued a 15-page report setting out its Brexit demands. The UK is not only a significant market for Japan, but also a base for Japanese manufacturers to export into the rest of the EU (a larger market). Any loss of existing free-trade arrangements is a key factor in their business models.

The message from the real economy to regulators should be to hold the line on globalisation or risk that their economies suffer the higher cost of local production for local markets, and increased layers of duties. (See the trade agreements story on page 11.)

IKON IMAGES

View briefing notes, technical updates and policy submissions at www.treasurers.org/technical. Our library of Brexit-related resources can be found at www.treasurers.org/brexit

For more immediate responses to events as they occur, the policy and technical team continues to write various blogs at https://blogs.treasurers.org. Please get in touch if you have something you'd like us to post as a blog on our website

{ INTERNATIONAL }

TRADE AGREEMENTS FOR BLUFFERS

The practicalities of how one separates a country from a 'club' that has formulated its regulation for 40 years is only now being discussed and it is important for treasurers to grasp the nature of the problem that will impact the real economy that they finance.

Currently, the UK is a member of the EU, which is a tariff-free area within which goods and services move across borders without duties. Goods entering the EU are considered imports only at their initial point of entry. Clearly something needs to be put in place to ensure continuity of access to markets following the conclusion of the two-year Article 50 period in 2019.

Two principle types of possible trade agreement are:

1) World Trade Organization (WTO) treaties. The 160+ members of the WTO have schedules of agreed duties on goods and services, which take effect where they do not have bilateral agreements: known as Free Trade Agreements (FTAs).

2) FTAs are agreed bilaterally. Hugely detailed, traditionally, these take many years to negotiate (and often almost as long again to implement). Any favourable tariff arrangements must be established via an FTA as the WTO legislates against any preferential treatment of trading partners through its most-favoured-nation concept.

In theory, it may appear to be 'easy' to adopt WTO treaties, but: a) the UK does not currently have its own schedules – it operates under the auspices of the EU schedules. One might think that the UK could 'just' adopt the EU schedules – fine in some sectors, but in others there are quotas tied to differing tariff levels and the separation of the quota between the EU 27 and the UK would need to be agreed both between the EU and UK, and then with the WTO (rest of the world); and b) any movement to WTO tariffs will immediately increase the cost (possibly by double-digit percentages) of doing business for a wide number of sectors.

Neither the EU 27 nor the UK have laid down any negotiating points yet, but reliance on WTO would mean that as a 'blue sky thinking' example, the UK could not offer to allow EU food to come in duty-free, to meet its 40% domestic shortfall in food, in return for duty-free exports of financial services, without doing so for all WTO members.

So what about an FTA with the EU? History shows these can become marathon negotiations spanning years as each party pushes to optimise the result for themselves. And within the EU there will be 27 parties doing so.

ALAMY/SHUTTERSTOCK

{ WATCH THIS SPACE }

Professional standards

One of the consequences of the global financial crisis has been the recognition that it is necessary to address the behaviours of the people working in the markets and that regulation alone is not sufficient.

This has led to the issue of a number of professional standards and guidelines to which bankers are expected to adhere, in particular the Senior Managers Regime. To date, these guidelines have not directly impacted on the activities of corporates, but in May 2017, a global FX code and a sterling code (the latter covering UK securities lending, repo and money market code), which together replace the old non-investment products code, will be published. As market participants, corporates should be aware of these codes. The ACT is working with regulators on establishing the appropriate level of corporate understanding and support, and would welcome any input. Email technical@treasurers.org

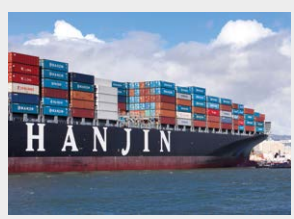
{ TECHNICAL ROUND-UP }

European Market Infrastructure Regulation – new regulatory technical standards/implementing technical standard

New standards have been issued for implementation effective during 2017. Your trade repository (TR) should make you aware of these changes that will affect derivative reporting field specifications. Those members who do not delegate reporting may need to change their input processes and they should ensure they understand what the changes are, when the implementation date is set at their TR and whether retrospective changes are required.

Real economy woes: not 'too big to fail'

The collapse of Hanjin Shipping has left cargos blocked at docks and on the high seas. A passing comment in a *Daily Telegraph* article (www.telegraph.co.uk/business/2016/09/18/fees-rocket-for-collapsed-cargo-giant-hanjins-clients) highlights the risk to the real economy when debt overwhelms a business that ships goods to hungry Western consumers, in a world in which scale has been associated with efficiency. Estimates are that 400,000 containers with goods (some of which are perishable), belonging to 8,300 owners were stranded on ships at docks, sitting outside ports and on the open sea. The financial services 'sting in the tail' for importers is whether their insurance is sufficiently comprehensive to recover the costs of late deliveries or indeed of getting their goods landed.



SHARN HAWKINS

SENIOR TREASURY ANALYST AT THE ROYAL BANK OF SCOTLAND

How did you get into treasury?
I was invited to be a part of the set-up of London Mid-Tier Treasury at PwC; I didn't know much about treasury, but I saw it as a great opportunity.

What do you like about treasury?
Treasury is very central and very critical to a business, and touches upon a vast range of areas. You can be looking at cash management structures one day, then the next be covering pension risk or how Brexit or 'The Donald' may impact business in the future. I really enjoy the broadness of the role and the value your insight can bring.

What's the best thing about being a treasurer?
Being able to really drive change and generate value for a business.

What's the best thing about being a member of the ACT?
The support network.

Which ACT qualifications do you hold? For example, AMCT/MCT/CertITM
AMCT

How has your qualification benefited you in your career so far?
It has helped ground my understanding of treasury and is something I can refer back to, no matter what role I am in.

What would be your best piece of advice to someone else considering a career in treasury?
To speak to people both inside and outside of treasury, people who know you both personally and professionally and, where possible, arrange shadowing opportunities to allow you to make an informed decision.

What's your ultimate career goal?
To inspire and lead a large team.

If you weren't a corporate treasurer, what would you be and why?
It would likely incorporate some form of design and running my own business.

If you would like to star in our 60-second interview slot, email editor@treasurers.org. Please provide a photo of yourself, your email address and telephone number. We won't publish your details – it's just so we can contact you in the event of queries.

ACT DIARY DATES

TRAINING, EVENTS & WEBINARS

TRAINING COURSE DATES

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23-24 November, London
Mechanics of corporate funding
Raising debt financing is one of the most important roles of a treasurer. We've designed this course to help guide you through the process. This course looks at why companies borrow, provides you with an overview of the sources of debt funding and range of instruments available and will examine the financial risks to your firm.

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ACT EVENTS

9 November, London
ACT Treasury Forum
In partnership with HSBC, through a combination of keynotes, panel discussions and roundtables, delegates will discuss the impacts of political risk and technological evolution to consider how the form and size of the treasurer's world is changing and what that means for business. This is an invitation-only event for senior corporate treasurers.
www.treasurers.org/treasuryforum

9 November, London
ACT Annual Dinner 2016
With more than 1,400 guests, the ACT Annual Dinner is a firm favourite with key members of the finance community and friends of the ACT.
SOLD OUT
www.treasurers.org/annualdinner

22 November, London
ACT Working Capital Conference 2016
After a successful inaugural conference last year, the ACT Working Capital Conference returns for a second year. Efficient and careful management of working capital is crucial to the survival and growth of businesses, and this conference will delve into current trends, best practice and industry-specific case studies. Get a broad and holistic view of managing your working capital.
www.treasurers.org/workingcapital

24 November, London
ACT breakfast briefing: Setting the bar for FX risk management
The Foreign Exchange Working Group of the Bank for International Settlements recently released the first phase of the Global Code of Conduct for the Foreign Exchange Market. This breakfast briefing will review the crucial considerations for corporate treasurers preparing to meet new rules and regulations and manage their FX risk in the long term.
www.treasurers.org/fxriskmanagement

8-9 February 2017, London
Smart Cash Management
The world doesn't stand still and nor should your cash. In an age when reinvention is key to survival, this two-day programme utilises new interactive formats to best deliver the need-to-know content at the bleeding edge of cash and liquidity management.
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ACT Annual Conference
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{ WORLD BANKING }

JEREMY WARNER

Do the current travails in the global economy mirror the circumstances that precipitated the Great Depression, or is it a question of degree?

Are we about to see events repeat themselves? Students of economic history will know that the Great Depression was a two- or three-stage catastrophe. The first phase began with the Wall Street crash of 1929. However, the Great Depression itself was more the result of a subsequent banking crisis. This began in Europe with the collapse of Austria's biggest bank, Creditanstalt, in 1931. The shock waves from this implosion spread across the world, resulting in a cascade of interlinked banking runs and insolvencies that ended up overwhelming the global economy.

Looking at the travails of Deutsche Bank today, the parallels are all too obvious. The first phase of the global financial crisis began in the US mortgage market, but then spread to Europe, and now seems to be snapping at the heels of one of its systemically most important banks.

Yet, despite the apparent similarities, there are also key differences. Deutsche is a huge bank with around €2 trillion of assets, but it is still easily within the capacity of the German government to bail it out should things deteriorate further. For political reasons, German Chancellor Angela Merkel has insisted there will be no such intervention, but in practice there are virtually no circumstances in which Deutsche would be allowed to go bust.

IKON IMAGES

Even so, the situation is precarious. More worrying still, it is symptomatic of wider problems within European banking as a whole. There are essentially four big negatives at work here: US misconduct fines, zero interest rates, tougher capital requirements and the competitive challenge of fintech.

Having already fined most of the big US banks over mortgage mis-selling, the US Department of Justice has turned its attention to Europe. Typically, banks will settle for a half or less of the sum originally suggested. It seems highly unlikely Deutsche Bank would be forced to pay the full $14bn regulators are gunning for. Even so, the fines come at a particularly vulnerable moment for the European banking system, already struggling to cope with the collapse in returns brought about by the low interest rate environment. Worse, for some European banks, this is not where it ends. A number, including Deutsche Bank, face further fines for alleged Russian sanctions busting.

Rightly or wrongly, European bankers believe they are being unfairly penalised. For instance, if JPMorgan were to be fined a similar proportion of its market capitalisation as Deutsche Bank, the sum would amount to a jaw-dropping $200bn. The fines are punishment, some believe, for the action taking by the European Commission against Apple for tax avoidance. A similar criticism is levelled at so-called 'Basel IV' capital requirements, which seek to place an absolute floor on the amount of capital banks must hold regardless of the riskiness of the loan book.

Analysts have crunched the numbers and concluded that many European banks are severely undercapitalised. It may make sense to impose the new standards for safety reasons, but again, they hit European banks harder than US counterparts. What's more, it has become virtually impossible to raise new capital in circumstances where it is seen to be immediately snaffled by US regulators.

Zero interest rates have further steepened the challenge, undermining margins and, therefore, traditional business models. It may be possible to charge big corporates for deposits, but it is almost impossible to do it to individual citizens.

To cap it all comes the competitive threat of fintech. Big banks are used to having it all their own way, but now there is a growing wave of entrepreneurial endeavour promising to eat their lunch, such as Peter Thiel's N26 in Germany, a mobile banking app.

History may not be about to repeat itself exactly, but eight years after the start of the financial crisis, Europe's incumbents remain firmly stuck in a life or death struggle for survival.

The first phase of the global financial crisis began in the US... but then spread to Europe

Jeremy Warner is assistant editor of *The Daily Telegraph* and one of Britain's leading business and economics commentators

Time to square up to the unpalatable

Central banks have played a reforming economic role. It is time for the governments of developed countries to do the same

Are ultra-low interest rates in the developed world here to stay? Not necessarily. The slow-growth, low-inflation environment is in some part a natural economic phenomenon. Western populations are getting older; their citizens demand less credit and more savings than before; and lower interest rates are required to balance money markets. In addition, as developed economies become ever more sophisticated and advanced, the degree of incline on the hill of discovery gets ever steeper. However, growth is still more sluggish than it ought to be, and this *is* self-inflicted.

Economic growth will remain in a low gear until the leaders of the developed world take a more balanced approach to economic policy. After the 2008 Lehman mega-recession, central banks have been relied upon to stabilise financial markets, boost demand and prevent deflation all at once. Monetary policy can have powerful effects as it did in the years immediately after the crisis. But when economies face structural problems, monetary policy can only buy time.

Central banks have indeed bought time, as they continue to, by delving ever deeper into their policy arsenals, inventing new weapons when old ones run out, and doing what was once unthinkable, setting negative interest rates in some cases. Alas, the vigorous growth of the past has proved elusive. All the while their strained efforts have created risks and concerns of their own.

Monetary policy can provide an economy with extra fuel. But it cannot increase the size of its engine. Economic growth in the developed world will only experience a material and sustained acceleration if monetary policy is complemented with appropriate fiscal and supply-side policies.

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Most developed-economy governments can borrow at negative inflation-adjusted rates for 10 years or more. If targeted public investments can generate positive real returns, they ought to be undertaken. In the US and Europe this could help to offset the current weakness in private investment growth. Modestly higher government debt does not pose a serious risk in most cases. Governments that borrow in their own currencies, issued by their own central banks, need not worry much about rising borrowing costs from temporarily higher deficits.

Governments have been slow to develop policies and programmes that deal with the undesired effects of globalisation on the living standards of low-skilled workers. Real income growth for the top 10% of earners in Organisation for Economic Co-operation and Development countries since the mid-1980s to the late 2000s was 1.9% per year compared with 1.3% for the bottom 10%. Income tax cuts that raise the disposable income of low earners would likely raise demand and growth, and would reduce the attraction of populists, too.

Whereas fiscal policy can generate demand quickly, gains from supply-side reform are slow to take effect, but they have greater benefits in the long term. For the most part, supply-side reforms involve scaling back bad government policies of the past, often involving freeing up labour markets that have become sclerotic from excess regulation – think France. Both the UK under Thatcher and Germany under Schroder serve as examples of successful labour market reform. More recent examples include the likes of Ireland and Spain, which currently enjoy some of the fastest growth rates in the eurozone.

Governments in the developed world have taken their eye off the ball as central banks have made extraordinary efforts to support their economies. Labour market reforms can be politically unpopular. But sometimes the medicine is bitter. It is high time governments showed more courage in reforming their economies. Where there is fiscal headroom, it should be used as a temporary sweetener. With a more balanced policy approach, the world could begin to look a little more familiar. If not, the slower growth will become entrenched, and ultra-low rates will become permanent.

It is high time governments showed more courage in reforming their economies

Kallum Pickering is senior UK economist at Berenberg Bank

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{ LEADERSHIP }

COLIN TYLER

When all's said and done, addressing today's challenges comes down to advanced financial problem-solving, and treasurers are well equipped for that

Colin Tyler is chief executive of the ACT. Follow him on Twitter @ColinTyl

This is my last article for *The Treasurer* as the ACT's chief executive. I'm stepping down at Christmas after five years in the role. It's been both a pleasure and a privilege. When I took the job, I often wondered what it took to be a successful chief executive. I still do.

As I prepare to leave, I thought I'd share with you some of the lessons I've learnt in my time both as the ACT's CEO and more widely throughout my career. We have come to refer to these as my continuing professional development (CPD) tips, but very shortly they will merely become nostalgic ramblings. My predecessor left me plenty of tips. Indeed, they all came with a PG rating. He encouraged us all at the ACT to experiment and I am thrilled that during my tenure we have. I encourage my successor to do the same.

Like all professional bodies, the core route to success is to remain relevant to our members and wider stakeholders. After nearly 30 years as a member, it is crystal clear to me that the ACT still has a strong and continuing reason to exist. We continue to need fair and effective financial markets, where the natural risks that arise in international trade can be dealt with. Markets need to be made and trusted by all who bring their wares. For too long the unprepared, untrained, misinformed or the misled suffered misfortune. Fortunately, since inception, the ACT has been preparing its members and their real economy businesses with means to help build trade.

SHUTTERSTOCK

I'm delighted that we still have many members who were founders of the ACT back in 1979. Back then, why did the ACT form? Finance directors of the FTSE 30 (a phrase not often used these days) helped identify and then encourage the emerging treasury community to create an advanced body of knowledge about corporate treasury – in essence advanced finance problem-solving.

I've always wondered why, at the time, the UK finance directors didn't try to convince their then respective accounting professional bodies to develop these skills, given that they are such a prerequisite for business – as much then as they are now. In the next decade or so, I anticipate that accounting and financial reporting jobs will become progressively deskilled as cheaper rules-based automated finance practices become the norm. Increasingly, the accounting profession is encouraging its members and students to upskill and move towards higher strategic ground. Perhaps one day there will be an Institute of Advanced Financial Problem Solving. If there is, you can be sure that the ACT and its members will be at its core. After all, it's what we already do.

When I joined the ACT in 1988, it was to access a body of knowledge that could help me one day become a corporate treasurer. It worked and it's been fun. As I finish my financial career, sitting in the City of London, my baker's dozen of CPD tips are:

- Accept that you don't have all of the answers, but act, always, with confidence;
- Try to spot an answer when you see one and give credit to the author;
- Be bold;
- Demonstrate and stick to your core principles;
- Be consistent, even if it's painful;
- Pick well (both people and problems);
- Take risks with people, and encourage your team to do the same;
- Make sure everyone has their moment in the sunshine;
- Give your team space to grow... and they will;
- Listen actively, but learn when to ignore advice;
- Accept all offers of help;
- Be humble and remember it is a privilege to have the best job; and
- Remember to pass the baton before the end of the 'exchange zone'.

Thank you for all your support and continuing support of the ACT.

TRUMP
WHO'S BUYING?

A Trump win in the US elections is unthinkable from many perspectives, but that should not prevent a clear-headed look at the economic ramifications. Roland Hinterkoerner explores the issue

What if Donald Trump managed to prove the pollsters wrong and won this unprecedented race for the US presidency? While this has been an out-of-the-money option since the primaries, and despite scandal after scandal haunting his campaign, the man cannot be counted out easily. That gruelling thought is growing on more and more people, and some of the pundits have run through their strategy framework of how markets might be affected.

But are markets really prepared for what's to potentially come in the first place? I doubt it. There are a few public voices, such as fund manager Jeff Gundlach, the man who dethroned Bill Gross as the world's bond king. He is pretty convinced that Trump will make it, and his view is that this would not be a bad thing at all. On the contrary, he thinks a President Trump would be good for the US economy, at least initially.

Gundlach may not be wrong. Donald Trump's lingo on the economy doesn't only include the obvious scare about future trade policies. It has touched on a number of viable points, such as lowering taxes for businesses, spending on infrastructure and cutting red tape. If done sensibly, this part of his policy cocktail could have an at least short- to medium-term positive effect on the economy, the unemployment rate and inflation.

Markets haven't thought much beyond what kind of trade wars with the likes of Mexico, China and Japan he might instigate. But they should. While the holy grail in economic forecasting appears to be a Hillary Clinton win and more of the same economically, they would do better to think again. Clinton would have to cater to the millions of Bernie Sanders disciples and adopt lots of ideas he was advocating during the campaign. Taxes would have to be hiked, and red tape would be on the rise.

Let's think through what the Donald could achieve, if done properly. Lowering taxes significantly, as he proposes, would surely provide a bit of a Reaganesque renaissance and a respective boost, much like we saw in the 1980s. America needs to encourage existing and would-be entrepreneurs, as history has shown sustainable job gains are predominantly feasible in the area of SMEs.

Infrastructure spending would be key to the quick successes that Trump would depend on to get his feet on the ground in the White House. It is desperately needed across the nation, and if he doesn't take the plunge, who will? The entire world, maybe with the lone exception of Germany, is on course of expanding investment in infrastructure. Young Justin Trudeau across the border could be a good example of initiative in this field.

Benefits for the economy, labour markets and even inflation should be fairly imminent. The first question, however, is one of the durability of such effects. A massive boost in investment will not be sustainable over the medium to long run, and unless the entire economy catches on to it, the positive effects may deflagrate sooner rather than later. A subsequent pullback from the final rearing up of government and central bank stimulus could be even harsher.

The second question will be one of how to pay for all this spending. Coupled with tax cuts, federal and state budgets would come under enormous strain and deficits would be poised to rise significantly. Trusting that Trump was not serious about restructuring America's liabilities any time soon, the nation's debt would soon surpass the 20 trillion mark and a swathe of new Treasury bonds would be issued to raise the funds.

The third question then is the structure of this fundraising. Who would finance what would amount to a humongous spending bill of a Trump presidency in the first place? Contrary to the concerns some of the pundits may have, it should not be a problem, as bond investors will eventually not shy away from America's ever-increasing debt mountain, but rather see the logic in raising money for the country's crumbling infrastructure.

Purchasing infrastructure

Unless there was even another way... Canada, for example, is choosing to rely on its central bank to support new government debt that is earmarked for its infrastructure. Were the US to go down the same path, it would constitute a reopening of the Federal Reserve's quantitative easing programme in some shape or form. A central bank purchasing infrastructure debt directly isn't exactly a new concept, but it would certainly lead to a widespread debate in the US.

If the undertaking were to be financed in the public bond markets, the wave of new supply would have to be digested and likely leave a dent in the Treasury market, albeit on a temporary basis only. So, in case of a Trump win, it might be recommendable to remain invested in the stock market, but stay clear of bonds, particularly longer-dated treasuries. Ten-year yields could potentially push up markedly beyond 2% in the ensuing months.

However, post such a market correction, investors should be ready to engage in the Treasury market again. Not much of a private sector follow-on in economic demand is to be expected from an infrastructure stimulus, and the world's hunger for yield is structural and will even surpass a Trump presidency. The time when investors will hesitate to have exposure to the Treasury market is quite a long way off still.

An envisaged correction in bond prices will make it even easier for investors to buy more of them. As we should all be aware by now, we live in an era when we cannot rely on cyclical economic patterns any longer, not even if those patterns were being helped by extraordinary spending. Rather, it is a structural shift driven by demographics, lack of credit demand and a disinflationary trend that we are dealing with.

Against that background, not even Donald Trump will be able to hold the fortress for very long. He would try to shape his legacy as a pragmatic doer right from the start – but only to go down in history as a tragic figure, as someone who had interesting intentions and set out to do right by his constituency, but who ended up doing terrible things and eventually bringing the whole house of cards down.

He may denounce the debt mountain his predecessors have built up, but end up presiding over pushing it even higher into more unsustainable levels. He may genuinely want to protect American jobs, but end up alienating the rest of the world and starting trade wars that are to no one's benefit. He may think acting as the first isolationist US president in modern times furthers America's cause, but end up stirring up a new sort of multipolar world that might have dangerous consequences.

In historian Niall Ferguson's words, Trump represents a choice between the status quo and change, or more specifically SNAFU (situation normal all fouled up) and FUBAR (fouled up beyond all recognition). Stay tuned.

Roland Hinterkoerner is founder of consulting and online financial publishing business Expertise Asia www.expertise-asia.com

A JOB WELL DONE

Making the operation more efficient, negotiating successive rounds of acquisition funding and seeing people grow in their profession bring Rando Bruns, head of group treasury at Merck, considerable satisfaction

Words: **Liz Loxton** / Photography: **Louise Haywood-Schiefer**

A career in finance was always on the cards for Rando Bruns, head of group treasury of pharmaceutical and life science and technology group Merck. "From a young age, I wanted to work with money; I wanted to work in a bank," he says. "It was less about wanting to be a policeman or a fireman for me."

Bruns took the swiftest route available, leaving school for an apprenticeship at Oldenburgische Landesbank in Westerstede, Germany. He embarked on a BA in European Finance and Accounting, studied jointly in the UK and Germany in 1991, and enrolled on an MBA as a Fulbright Scholar at Kent State University in the US in 1995, and came to realise that he wanted to explore finance from the corporate side.

Bruns joined General Motors' Opel, in Rüsselsheim, as a financial analyst and then became team leader in treasury. After three years, he moved to Elexis, a specialist machining company where he was head of finance and investor relations. Two years later, he moved to a Munich subsidiary where he was general finance manager. It proved to be a testing environment, with orders falling sharply post September 11. "It was very tough," he says. "We didn't know if the company would make it. One of my first jobs was to lay off 15% of the workforce, which was one of the toughest days in my career. Money was short and every week I had to call the vendors to negotiate how much we could pay."

The company returned to profit, but by 2005, Bruns wanted to bring to an end his weekly commute to and from his home in Frankfurt. He joined Merck as head of cash and risk management, and became group treasurer in 2008.

It was the beginning of a period of significant change for the company. Merck's treasury employed only eight individuals at the time. Today, it stands at 40 and encompasses insurance management and pension asset management for the group, as well as acquisition financing. Merck's growth story was just about to begin. Treasury and Bruns would play a pivotal role.

Family involvement

Merck's structure is unusual in that it is public and private at the same time. Thirty per cent of the shares are held by the public, while the Merck family retains a 70% holding. This gives it a considerable personal stake and liability, but affords the company a certain flexibility. While quarterly results are important for investor relations, the family is also committed to handing its heritage on to the next generation. Furthermore, the family is personally liable, which also applies to the board of external managers.

"With the family there, you can be very fast moving. They are not actively steering the company – that is done by the board, but they are involved in strategic decision-making. If you need some sort of permission, this can be reached within hours, if need be."

With nearly 350 years of heritage, Merck is a business of long-stayers. Very few trainees leave the company, which has also grown significantly by acquisition. "We have bought businesses for more than €30bn and sold businesses for more than €8bn. So there has been a change in culture over the past 10 years."

Most of Merck's acquisitions have been US and Asian businesses, and have cumulatively made the company more internationally focused. "We deal with 66 countries on a day-to-day basis. We try to make the workforce international and diverse," says Bruns.

The starting transaction was the 2006 deal to buy Swiss biotech company Serono, a €10bn, biotech-pharma link that was very important strategically. The 2010 purchase of Millipore for $7.2bn in particular expanded Merck's life sciences interests, and the $2.6bn acquisition of AZ Electronic Materials, listed in the UK, but with main businesses across Asia, also broadened Merck's footprint.

The completion of Merck's purchase of Sigma-Aldrich last year was significant for group treasury. In contrast to the Serono deal, where the family diluted its shareholding slightly in the interests of raising public funds, the Sigma-Aldrich acquisition, all $17bn of it, was cash and debt financed. The role that Merck's treasury team played bringing the transaction about and managing its banks brought accolades, including European Treasury Team of the Year in *The Treasurer*'s Deals of the Year Awards last year.

The acquisition financing was at the time the largest in Europe since the

financial crisis. A $15.6bn dual-currency loan facility was secured in September 2014 and was followed by a €1.5bn hybrid bond in December 2014 and a $4bn US bond in March 2015.

"The debt market plays a very important role for us and, therefore, treasury financing plays a very important role," explains Bruns. Treasury was involved in strategic decisions at a very early stage, leading discussions on the affordability of the deal and the implications for ratings.

Banks and their role

One of Bruns' ambitions for the financing was to strengthen relationships with Merck's 19 banks, but the direction he decided on was a singular one. Rather than allowing banks free rein to call team members and pitch for a stake in the Sigma-Aldrich transaction, Merck ran the show from the off. "Every relationship bank wants a piece of the cake and we were very strict on this. We had a strategy as to which bank we'd have, which position and what earnings, and there was no room for discussion."

Once the deal was public knowledge, Bruns made it clear that banks ignoring the 'no calls' rule might end up on a black list. In return, he offered fair and transparent treatment. Every bank fell in line. The feedback he received was that, although this approach had been difficult to swallow at the beginning, it had been easy for bankers to sell internally, because Merck was transparent and as good as its word on outcomes. "We want banks that want a long-term relationship and while you are tough on pricing, you have to be fair, so this worked really well," he says.

"What I like about the ACT is that it has built a platform for networking and communication"

The FX management of the transaction is also an area he is proud of. Being involved in the strategic discussions, Bruns understood that Merck would soon be in the market for an acquisition using dollars rather than euros, so two years prior to the Sigma deal, he began discussions on setting up a funding vehicle that reported in US dollars. Merck established an in-house bank in the US to accumulate currency, increasing equity and converting euros into dollars.

"That was the first step. If the acquisition hadn't happened, that wouldn't matter; we just had US dollar cash in a US dollar entity, which we could live with for a certain period of time."

At that time the US dollar was well above $1.30 to the euro and Bruns' view was that the euro would weaken and the dollar become stronger. "There was a point when we had an agreement [to purchase Sigma], which was friendly. We had an agreement on price and on some other aspects of the deal already. But we would need to finalise on technical areas. And at that point we could see the USD/EUR exchange rate moving further down and we said 'we have to do something; we will lose a lot of money if we don't'.

"We were hedging our remaining US dollar exposure at that point. As we had already considerable US dollar cash available and already decided to do some US dollar funding, we went out into the market and bought plain vanilla USD/EUR options for our remaining FX exposure of $10bn – and we did so with the expectation we would sign within the next few weeks, at which point we would sell the option and go straight into a forward."

Merck did not take the cheapest option, however. "We bought a one-year option because we wanted to lose as little in option time value as possible, to look for an efficient way. So we spent €100m on option premiums. This is quite some investment. You need

RANDO'S TOP TIPS FOR SUCCESS

1. **"Think about what you can bring to the table to move the company forward as well as to improve the life of your colleagues in different functions of the organisation. Have a holistic view of the company and do not be only treasury-focused."**

2. **"You do not learn treasury at university; it's learning by doing. The professional qualifications, like those from the ACT, help, but they are mostly for people who are already in the profession. I have made very good experience with our own specialised two-year treasury trainee programme as a starting point."**

3. **"What I like about the ACT is that it has built a platform for networking and communication. It's more international than any other treasury organisation, so for me it's an opportunity to meet treasurers and peers from the UK and other countries. Networking is very important in today's world."**

4. **"For me personally, the secret to career success is that I am in a profession that truly matches my personal interests. I enjoy building a team with which high goals can be achieved. It is also a pleasure for me to develop, challenge and assist colleagues in their professional growth."**

confidence and back-up from the board and Merck family to do that. Three weeks later, we sold it for €200m, so the strategy paid off. Then we moved into the forward and managed this towards the end. Overall, we applied a hedging strategy according to the deal probability – and we did this very consciously. The overall benefit was more than €2.1bn. Our average hedging rate was above $1.30." When Merck completed the acquisition a year later, the dollar had indeed strengthened substantially; by then the rate was close to $1.10.

Post-deal integration

With considerable deal experience, Merck has been able to hone its post-transaction approach. Bruns understands the importance of grasping the nettle early. Once the deal is signed, the company begins negotiations with anti-trust lawyers on the scope of discussions with the other company's treasury function. Many companies begin the integration process once the deal is closed or shortly after. "We have a different approach; we want to be done on the day of closing," says Bruns. "We sit with the anti-trust lawyers of both parties in order to prepare integration very early and say: we will talk about treasury; we don't talk about customers, products, prices, vendors – nothing that would give us a competitive advantage if the deal doesn't go through."

Bruns also believes in early discussions with IT to ensure both parties connect successfully on completion and early involvement of the bank in order to be ready for day one. "Cash pooling should go live with closing. In order to achieve this you need to set up bank accounts for [businesses that are] not already in your group. You maybe want to make penny payments and start testing, which is difficult for them and you typically get rebuffed, two or three times, but I can tell you it's feasible," he says.

Looking ahead

Facilitating Merck's growth has to coexist with the day-to-day tasks, of course – such as managing FX risk and keeping a watchful eye on governance issues. The team is also implementing a completely wide-ranging new IT set-up for treasury, triggered by Siemens, which is withdrawing its cash management system finavigate from the market.

Similarly, regulatory issues must be faced up to – Section 365 regulation in the US, the Money Laundering Act, the Financial Transaction Tax.

Risk management and political risks are more open questions. Merck hedged against falls in sterling ahead of the Brexit vote, but with most of its business outside of the euro, the weaker pound and weaker euro have been unproblematic. It's the wider implications of the EU that will exercise Merck. "Overall, we've benefited from the FX exposure. I think, as a company, this might impact us in terms of regulation. What will it mean when you want to license a product, for instance?"

The outcome of the US election and wider political risk are harder to call, however. "It's another loose bullet," he says. "In risk management you discuss what could be and what is the next 'maybe'. The big things, you don't see. The shark that bites you comes from underneath. We have a very bumpy and volatile road ahead of us, I'm sure of that."

Team spirit

In the meantime, the team's capabilities and role in Merck's development bring him a great deal of satisfaction. "Firstly, enabling the growth of the company – to support this and to help the business with efficient processes – that's where the satisfaction lies. Secondly, the teamwork: I think we're as good as we are because we're a very good team. Each individual in the team is there when they are needed and goes beyond their tasks by going the extra mile, as well as working jointly with and for each other. We're a diverse team. You need a completely different skill set for all the different tasks – and that makes us rich, I would say."

VITAL STATISTICS

1668
year of foundation

50,000
employees worldwide

€12.8bn
revenues in 2015

66
number of countries in which Merck operates

€1.7bn
R&D spend in 2015

RANDO'S CV

2005-present
Head of group treasury, Merck (head of cash and risk management until 2008)
2000-2005
Head of finance at an Elexis subsidiary (head of finance and investor relations at Elexis AG Frankfurt until 2002)
1997-2000
Head of cash and risk management at Opel (financial analyst until 1998)
1986-1996
Banking roles in Germany and the US

QUALIFICATIONS

1995-1996
MBA from Kent State University
1991-1994
BA in European Finance and Accounting from Bremen University and Leeds Metropolitan University
1988-1990
Higher Examination in Banking
1984-1986
Examination in Banking

Liz Loxton is editor of *The Treasurer*

SPHERE OF INFLUENCE

The torrent of regulation since the financial crisis has spurred more treasurers on to become advocates for their profession. Sally Percy finds out what they do and how they do it

Influencing and advocacy work has been one of the ACT's priorities since the founding of the professional body in 1979. Throughout the decades, its aim has remained the same: to ensure the voice of the 'real economy' is heard in discussions around financial policies and regulations.

One of the ACT's earliest successes was persuading the government to establish a sterling commercial paper market in the 1980s. In more recent years, it has been active in influencing policy in a range of areas, including base erosion and profit shifting (BEPS), Basel III, the European Market Infrastructure Regulation (EMIR), the *Fair and Effective Markets Review*, the *Wheatley Review of Libor*, money market fund (MMF) regulation, payment processes and the proposed bank ring fencing arrangements.

This level of activity is only possible because the ACT's policy and technical team constantly monitors the external environment and the media to find out which regulatory developments in the UK and EU may impact on treasurers. The task has become considerably more challenging since a wave of regulation swept over the financial services sector in the wake of the financial crisis. As a result, the ACT has often found itself confined to a firefighting role.

"Because of the pressure of regulation post 2008, we've tended to be reactive," explains Stephen Baseby, associate policy and technical director at the ACT. "Now we're trying to get into the debate as soon as an issue arises." Taking Brexit as an example, he adds: "We know politicians are working out what they want to do. So we want to talk to them now."

Pleasing most people most of the time

As a membership organisation, the ACT acts on behalf of its membership. So it needs input and support from its members if it is to succeed in influencing any debate.

Of course, it's not always appropriate for every treasurer to comment on every topic. While the impact of the Basel III framework on bank capital and liquidity ratios may affect all treasuries to some degree, a consultation by the UK Payment Systems Regulator may only be of interest to treasuries that handle substantial numbers of payments and receipts. "We have to be quite specific each time as to who we are trying to influence and which part of our membership we are representing," says Baseby.

Treasurers are very busy people who have a lot on their plates, so why is it important that they spend time trying to influence policy? "No one else is going to think about how regulation is going to affect treasurers

from the point of view of treasurers, particularly when the impact is indirect," observes John Grout, who served as the ACT's policy and technical director between 2002 and 2015.

The case for a treasurer to get involved in influencing is a strong one, argues James Harvey, assistant treasurer at engine manufacturer Rolls-Royce. "A huge amount of financial regulation impacts corporate treasuries. Most of it is well intentioned, but it can have unintended – or intended – consequences. It is important that corporates express their views as early as possible in the development of the regulation so that they can be considered before it's too late and positions become ingrained."

One regulatory development that particularly galvanised the treasury community was the adoption of EMIR in 2012. In addition to new reporting and clearing requirements, EMIR originally required corporates, as well as financial services companies, to post collateral against their derivative positions. Thanks to lobbying by the ACT and others, this requirement was later dropped for most non-financial corporates.

John Jackson, group treasurer at utility company Severn Trent, helped the ACT with its advocacy work on EMIR while he was working for his previous employer, engineering company The Weir Group. "The Weir Group had very sizeable FX requirements," explains Jackson. "And the initial EMIR proposals would have had a very significant impact on our ability to enter into derivatives contracts. We would have had to put a significant lump of cash behind our derivatives, which would have had a liquidity impact and could have led to sizeable risk if there were significant market moves that meant more cash being called. We managed to get that requirement pushed back."

> "No one else is going to think about how regulation is going to affect treasurers from the point of view of treasurers"

Stronger together

Since many regulatory initiatives are global, a UK voice, however loud, is inevitably only one of many voices being heard or not heard. So the ACT combats this challenge by joining forces with other treasury associations. For many years, it has worked closely with the European Association of Corporate Treasurers (EACT) to influence European legislation and it has a constructive relationship with the National Association of Corporate Treasurers (NACT) in the US.

The ACT also links up with non-treasury professional bodies and trade associations. It worked with the Chartered Institute of Taxation on BEPS and it also liaises with the Confederation of British Industry on issues of mutual concern. On certain topics, it may find some natural alignment with financial services trade organisations, which tend to be well financed and influential.

"Banks understand the importance of lobbying and use their trade associations at every opportunity," says Sarah Boyce, associate policy and technical director at the ACT.

Harvey emphasises how treasurers can work with peers from across Europe to present a common corporate front to regulators. "We work with the ACT, EACT and a number of other large corporates from around Europe to try and ensure that corporates have a voice," he explains.

"This generally involves analysing the text of developing pieces of regulation to try and spot areas of concern, discussing these issues to develop a common understanding of the problem, responding to consultation processes and raising our concerns with the relevant parties. If you've got a large group of corporates from across Europe saying the same thing, then your arguments, statements and positions have a lot more weight."

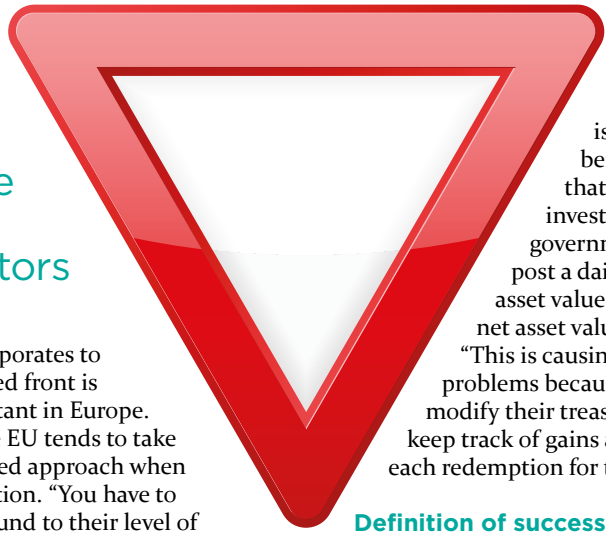
REFLECTING TREASURERS' VIEWS

The ACT consults its policy and technical committee as to which regulatory areas should be a strategic priority. This committee includes ACT members as well as consultants, lawyers and tax specialists.

It also has a treasurers' forum, which is a group of more than 100 treasurers from organisations of different sizes, who have agreed to answer email questions. The ACT may invite treasurers from this group to go to private meetings with the Bank of England or another regulator for discussions on a particular subject.

When it is responding to a consultation, the ACT will come up with a view based on the opinions of its members who are affected by a particular development. In its response, it will look to demonstrate how a particular policy will impact on the economy more broadly, not just on large corporates.

Treasurers can work with peers from across Europe to present a common corporate front to regulators



The need for corporates to put forward a united front is particularly important in Europe. This is because the EU tends to take a consumer-oriented approach when drawing up legislation. "You have to turn everything round to their level of thinking," says Baseby. "You have to say, 'Your consumers are paying this and that. This is how we change that.'" UK legislators, on the other hand, are more inclined to take a broader view of an issue and have more sympathy for corporates.

While the ACT will remain a member of the EACT, Brexit will potentially weaken the ACT's influence in Europe. "We will be more able to influence UK legislation and less able to make ourselves heard on the world stage," says Baseby.

Advocacy across the pond

In the US, the NACT has been active in influencing policy and its chairman, Tom Deas, has personally testified to Congress several times. By connecting with other like-minded business advocacy organisations through the Coalition for Derivatives End Users, the NACT has scored two notable victories with regard to the Dodd-Frank Act. The first was getting corporate end users exempted from having to post cash to margin for the daily mark-to-market of their derivative positions. The second was securing an exemption from clearing requirements for corporate swap end users' treasury centres.

The battle against excessive regulation continues, however. Currently, the NACT is opposing new actions by US banking regulators that require banks to hold higher capital for derivatives trades with end users. Deas says the proposals "negate the benefits of the exemption from margining, since they have the same economic effect as if the end user had to post margin and increase the cost of doing the trade".

Treasurers are also getting headaches from additional regulations affecting US money market mutual funds. "Particularly onerous is the requirement being implemented that prime funds, investing in non-government securities, post a daily variable net asset value instead of a fixed net asset value," explains Deas. "This is causing treasurers major problems because they have to modify their treasury systems to keep track of gains and losses on each redemption for tax compliance."

Definition of success

While the ACT can boast many successes in its advocacy work, it's not always allowed to talk about them. "I can't tell you most of the policy successes because they're things we headed off, which didn't happen," says Grout. "But I can tell you that treasurers would be much less happy." He does, however, cite the foundation of the UK commercial paper market, the amends to the 1986 Financial Services Act, the introduction of UK withholding tax rules for privately placed bonds, work done during the financial crisis, the Libor review and EMIR as examples of the ACT's success.

"Very rarely does the ACT set out to overturn government policy on something because we would never succeed in that," he explains, "but very often we nudged them away from things that were really terrible and had to settle for things that were simply unacceptable."

"We would probably say that the greatest success has been the outcome, so far, of EMIR," says Baseby, "and the fact that we persisted with arguments against dual-sided reporting, which are beginning to have some effect."

Another important win is how advocacy work has helped to raise the profile of treasury both within the regulatory and the business communities. "The Bank of England will phone us up and ask us about things," says Boyce. "We've worked hard to make sure they see us as a resource."

Harvey confirms that regulation ranks highly on Rolls-Royce's strategic agenda. "It's been discussed at board level," he says. "It's definitely on the CFO's list of key things we need to keep on top of. From a treasury perspective, it's been one of the priorities since 2009."

Acknowledging the achievements of the ACT, Deas remarks: "The ACT is very dedicated to the treasury profession and it has a staff of very knowledgeable people. It has the resources and capacity to speak

WHAT TO DO IF YOU WANT TO INFLUENCE

- **Express your interest to the ACT's policy and technical team via Stephen Baseby (sbaseby@treasurers.org) and Sarah Boyce (sboyce@treasurers.org).**
- **Read widely and use social media to follow key journalists. You can also keep up to date by reading *The Treasurer* and the EACT's monthly report on regulatory issues, which is available on the ACT website (www.treasurers.org/node/9894).**
- **If you are invited to attend a private meeting with regulators, make sure you know your facts and understand how the proposed changes in legislation will impact the economy more broadly (not just your own business).**
- **Join the ACT's treasurers' forum.**
- **Remember that a meeting with regulators can be an opportunity for less senior members of the treasury team to raise their profile and get experience of the influencing process.**
- **Maintain relationships with the key regulatory contacts you make. They may be useful in future.**

directly on behalf of treasurers. We very much value the NACT's close working relationship with the ACT."

Future challenges

Keeping on top of regulation is an ongoing battle that won't be made any easier by Brexit. As Baseby points out, Brexit will require the UK to rewrite every trade agreement it has with different countries, with the result that new import duties could affect supplies of raw materials and increase the cost of doing business.

He also predicts that there could be a divergence of regulation along interventionist, protectionist lines – in contrast to the convergence of regulation that has marked the past few decades. "The risk is that regulation could become more of a distraction to business and affect the real economy," he notes.

Boyce highlights that the rise of protectionism in the US and China presents risks, along with the global low interest rate economy and volatility seen in both the commodities and FX markets.

Brexit will require the UK to rewrite every trade agreement it has with different countries, with the result that new import duties could increase the cost of doing business

Treasurers, meanwhile, have their own concerns. Harvey will be keeping an eye on the European Commission's upcoming review of EMIR, as well as further amendments to the Basel capital rules, the Global FX Code of Conduct and changes to MMF regulation. Jackson is monitoring MiFID II and banking rules.

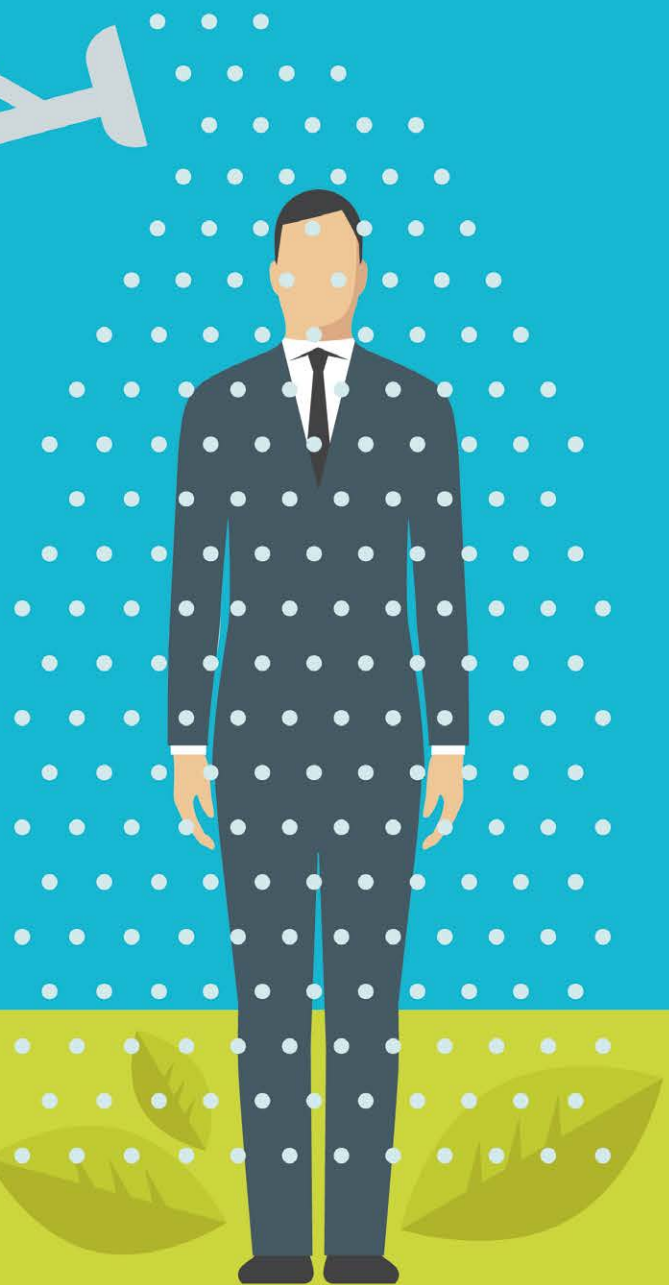
If treasurers are concerned about the threats posed by the external environment, influencing work presents them with a great opportunity to make a difference. As Boyce puts it: "We're all advocates now."

Sally Percy is a business and finance journalist and former editor of *The Treasurer*

If we support students, this, in turn, helps their employers work more efficiently, effectively and ethically

HOW TO SPEND IT

The ACT's bursary programme extends support and much-needed financial backing to would-be treasurers in developing countries, helping them to have a sustainable impact on their companies and environment, writes Lucy Gee



Just over 10 years ago, the ACT Educational Trust launched a bursary scheme, providing financial support to students in developing countries, who were not in a position to fund their ACT studies. During this time, the bursary scheme has helped more than 50 students complete an ACT qualification.

ACT's Chartered status mandates that it should operate in the public interest, and the bursary scheme is a key way in which the ACT can bring significant benefit to employers, emerging economies and the students themselves.

The rationale for this is that if we support students in building their professional competency, this, in turn, helps their employers work more efficiently, effectively and ethically. This then positively impacts the regions and economies in which they operate, the goal being that both capacity and capability grow in treasury against globally recognised competency standards.

For the students themselves, completing an ACT qualification often has a significant impact on their career, giving

BURSARY BENEFICIARIES

Chikondano Chisala, senior treasury dealer, NBS Bank, Malawi

Chisala was one of the first students to complete CertTF under the bursary scheme. Having achieved a distinction, Chisala is now studying towards the CertT qualification. She was selected as one of the ACT's 2016 'Ones to Watch', a group of 16 treasury professionals who we see as tomorrow's treasury leaders.

"I joined NBS Bank as a management trainee and first came across the treasury world during one of my rotations," she says.

Chisala applied for the ACT bursary scheme to study CertTF with the hope of gaining global expertise in treasury and working towards ACT accreditation. "I found CertTF to be relevant to me as a treasury professional working in a developing country, particularly with regard to understanding advanced risk-management tools to manage financial, business and operational risks that are very common in developing countries.

"Studying with the ACT opened many doors for me. I was promoted to senior treasury dealer. Last year, I was the lead representative from treasury on a project team to upgrade core banking systems, working on the swaps and forward contract modules. I find the involvement with international markets exciting."

She continues: "The CertTF and CertT courses are rich, well structured, practical and they have equipped me with tools to apply in my day-to-day operations as well as provided me with a good foundation to support my future career aspirations."

Wisdom Akakpo, dealer, Barclays Bank, Ghana

Akakpo is one of two students who have now completed both CertTF and CertT under the scheme, achieving a distinction for CertTF and impressively completing all five CertT units in one sitting. He is now planning to apply for a bursary to study the DipTM qualification.

"CertT deepened my understanding of cash and liquidity management, corporate finance and risk management markets, among others. The course has helped me improve in my liquidity and risk management roles," says Akakpo. "The online Learning Academy was of great use as I could interact with other students and tutors, and seek clarifications on any readings. The ACT team was very helpful and available to clarify and resolve any questions I had. I am humbled at the team's dedication to see me succeed."

One of his career objectives is to become a well-equipped, world-class global markets professional. "The ACT qualifications are comprehensive and internationally respected. The ACT Charter will broaden my knowledge in financial markets, sharpen my practical finance skills, improve my marketability globally, and prepare me as an agent of change in Ghana. Via the ACT mentoring service, I have access to a network of ACT Charter holders for mentorship."

He concludes: "Studying for CertTF and CertT was a great experience. Personally, I have never felt more equipped to become a world-class corporate treasurer."

Marcell Molnar, relationship manager, Deutsche Bank, Hungary

Molnar was the winner of the 2015 Gay Pierpoint Award, in recognition of being the highest-scoring CertTF student studying under the bursary scheme. He went on to study CertT, passing all five units in one sitting with either a merit or a distinction. He is currently studying towards DipTM with the support of the bursary.

Molnar says he began studying corporate treasury in an effort to better understand his clients. "While the ACT exams were challenging at times, the study material is up to date and crystal clear. As everything is available online, it was really easy to access anything I needed, including communicating with a personal tutor, access to the student forum and downloadable extra reading.

"It was a real honour winning the Gay Pierpoint Award, and actually took a few days to sink in. I am grateful for the bursary as it enabled me to complete these fantastic courses. The bursary application process was straightforward and I felt very supported throughout my studies. Most importantly, I was able to instantly apply what I learnt in my daily role."

Molnar's manager, Katalin Tornyai, head of global network banking for Hungary at Deutsche Bank, says: "Marcell's commitment to his ACT studies and his excellent exam results demonstrate his client-centric attitude and self-initiative. We are delighted to have people like him in Central and Eastern Europe."

SHUTTERSTOCK

them the confidence to take on additional responsibilities within their roles, the knowledge to make improvements to treasury processes within their organisations, or opening doors to new employment opportunities.

Since the launch of the new ACT qualification structure in 2015, we have seen consistent and impressive results from our students studying under the bursary scheme, with a 100% pass rate at the Certificate in Treasury Fundamentals level. On top of that, 86% of these students are going on to study the higher-level Certificate in Treasury qualification.

The ACT Educational Trust relies solely on charitable donations. With your help, we can continue to support individuals throughout the developing world who wish to forge a career within treasury. We therefore ask you to consider making a donation, however large or small, via the online donation form on our website: www.treasurers.org/acteducationaltrust/donationform

The Trust is also always keen to hear from people who are interested in joining the board as a Trustee. If you would like to request further information or a person specification, please contact Lucy Gee at the ACT (lgee@treasurers.org).

Lucy Gee is programme manager at the ACT

IKON IMAGES

SHINE A LIGHT

CORPORATE TREASURERS TREAD A FINE LINE BETWEEN SATISFYING PUBLIC PRESSURE TO DISCLOSE MORE INFORMATION AND KEEPING THEIR SHAREHOLDERS HAPPY, WRITES FARAH KHALIQUE

The buzzword *du jour* is 'transparency', as governments, regulators and the public demand greater insight into the workings of multinationals after a series of front-page scandals.

The unprecedented leak of the *Panama Papers* earlier this year put transparency – or rather the lack of it – in the spotlight. The International Consortium of Investigative Journalists leaked more than 11.5 million financial and legal records that exposed crime, corruption and tax avoidance within companies. A public backlash ensued, and since then transparency has stayed at the top of the agenda.

Central registry

Earlier this year, the UK was the first G20 country to establish a publicly accessible central registry in a bid to shine a light on companies. They now have to keep a register of 'people with significant control', showing who really owns and controls the company.

"Transparency is becoming a hot topic as sanctions, KYC and moving tax rules [such as the Organisation for Economic Co-operation and Development's base erosion and profit shifting project to reform international tax rules] start to bite," says Stephen Baseby, associate policy and technical director at the ACT.

KYC is paramount for banks to understand their customers, but the requirements have become so rigorous in recent years that it is becoming a barrier to trade, believes the ACT. "The treasurer is not always presented with a transaction where he has been able to ensure sound documentation or take the necessary steps to ensure prompt compliance with KYC, such as in procurement and confidential M&A deals," says Baseby.

On the one hand, treasurers need to be *au fait* with what is required of them – such as KYC – and on the other to be aware, or make their colleagues aware, of the interaction between 'real economy' business and regulation. "Although not necessarily financial, it comes into play when processing the financial parts of the transaction because that is the simpler bit to monitor," advises Baseby.

Treasurers should expect their activities to be impacted more in the future. This is not only from the push for

anti-avoidance of tax, but also for a more equitable allocation of tax revenues to those countries that have consumers. Corporates are expected to contribute to the social infrastructure to enable consumers to purchase goods and services.

Tax in the public eye

Across the pond, the US Treasury announced plans in April to curb tax inversion, whereby companies move their tax residence overseas to avoid paying US taxes. A number of US companies, including Apple, Google, Microsoft and Pfizer, have been accused of inversion and of "shifting a greater tax burden to other businesses and American families", according to the US Treasury.

The rule in theory targets blatant inversions, but it also has an effect on companies' day-to-day cash management activity, warns Tom Deas, chairman of the National Association of Corporate Treasurers in the US. It is currently standard practice for a company to pool its excess cash and lend it out to the different companies within the group structure. But the new rules will target these co-mingled funds, giving rise to an increased tax liability for corporates.

Deas says: "This has treasurers very upset. The [US] Treasury announced it would not be able to use its judgement to distinguish between actions that were abusive and those that were in the ordinary course of business. It would rather apply these rules uniformly to all transactions."

> The new rules will target co-mingled funds, giving rise to an increased tax liability for corporates

A crackdown on intercompany lending could mean that companies have to raise more capital via alternative methods, such as bank loans or the capital markets, meaning cash piles would be sitting idle instead of being put to efficient use.

Shareholders vs public interest

Companies face a growing dichotomy between the increasing disclosure requirements that need to be managed and their responsibilities to shareholders. This is particularly pertinent at publicly funded organisations, such as housing association Family Mosaic, which receives funding from the Greater London Authority and central government.

Michael Verrier is non-executive director at Family Mosaic, with decades of treasury experience under his belt, most recently at building materials distributor Wolseley plc, where he was group treasurer until last year. "When it comes to transparency in treasury, I feel many companies could do better. Reading annual reports, there is a lot of data required by accounting standards, but [this does not give a] clear picture," he says.

Stakeholders primarily want to know the company's policies for FX management, interest rate management, funding strategy and capital structure. Treasurers are understandably nervous about disclosing commercially sensitive information, but Verrier believes it is possible to provide a clear picture of how a company is managed by stating a few well-defined policies and operating parameters.

"Stating these clearly and applying these consistently will increase stakeholder confidence in the company," says Verrier.

For example, Family Mosaic has historically had a higher proportion of its debt at floating rates instead of fixed rates, making it an outlier among its peers. But its annual report is clear on the policy and that the position is under constant review.

CHARITIES FEEL THE HEAT

The pressure cooker of transparency is affecting companies great and small, including charities. Oxfam works in more than 90 countries to help relieve poverty in the worst-affected areas, from Darfur to Syria, but it faces hurdles sending money where it's most needed. Sarah Love recently started in the new post of head of global tax and treasury, which came about as a result of a company restructure. According to Love, the banking sector has become increasingly risk-averse in recent years, meaning that Oxfam has to spend more time and effort dealing with financial transactions in countries that are deemed by banks to be 'high risk'. Banks themselves face hefty regulatory fines if they are found to have breached anti-money-laundering, anti-bribery and corruption laws, even inadvertently.

Love says: "Banks are increasingly asking questions and trying to understand exactly where we work, what we're doing in these countries and seeking to understand internal controls we have in place to make sure money doesn't end up in the hands of terrorists."

Most recently, Oxfam hit a roadblock when trying to donate money to Syria. One of its intermediary banks in Germany that had previously transferred money to the region changed its policy overnight. It no longer wished to facilitate any transactions that involved sanctioned countries. For three and a half months, Oxfam could not get any funds into war-torn Syria. Eventually, the charity managed to find a new Belgian intermediary bank, but Love is fully aware that the same problem could repeat itself.

Meanwhile, charities that invest surplus funds with investment managers are coming under pressure to scrutinise exactly how the monies are being invested, and ensure they are paying the correct fees. Some charities are paying for active managers to invest the funds shrewdly, says Hanif Virji, partner at AHV Associates, but they are instead being funnelled into passive instruments like closet tracker funds that simply track a benchmark index like the FTSE 100. Active management is more expensive than passive management, meaning that some charities are therefore paying over the odds. Virji is currently compiling data to show which funds are advertised and sold as actively managed, but are actually doing no more than tracking indices.

SHUTTERSTOCK

Farah Khalique is a freelance business and financial journalist

COMING OF AGE

CHINA'S MONEY MARKET FUND INDUSTRY MAY HAVE BEEN SLOW OUT OF THE STARTING BLOCKS, BUT IT'S FAST GAINING GROUND – AND SCALE, SAYS AIDAN SHEVLIN. THERE ARE ALSO SIGNIFICANT CHANGES IN THE INDUSTRY'S RULES, AIMING TO REDUCE RISK AND DELIVER GREATER LIQUIDITY FOR CORPORATE CASH INVESTORS IN CHINA

The first Chinese fund manager opened for business in mid-2001. But it wasn't until August 2004 that the money market fund (MMF) industry took off with the first set of guidelines from the China Securities Regulatory Commission (CSRC).[1] After a slow start, the number of MMFs in China doubled between December 2011 and December 2013 – and doubled again by the end of 2015. Between 2011 and 2015, MMF assets under management (AUM) skyrocketed 14-fold to CNY 4.6 trillion ($704bn), accounting for roughly 55% of the Chinese mutual fund industry's total AUM (see figure 1, below). Globally, renminbi MMFs now represent 13% of global MMF assets,[2] up from just 0.5% in 2010.

The Chinese MMF industry remains dominated by retail investors, who typically focus on a fund's yield, size and ease of purchase when deciding which funds to buy. The industry is highly concentrated; the top 15 funds hold more than 60% of AUM. Historically, given limited distribution methods, fund managers typically focused on performance as their key differentiator.

Over the years, a niche, AAA-rated MMF industry has developed to serve the needs of more risk-averse investors, including local companies and multinationals operating in China. While these investors appreciate the benefits of higher, market-driven yields, they do not want to compromise liquidity and security.

Evolution of China's MMFs

Preservation of capital and liquidity has long been the primary objective of MMFs. With those goals in mind, Western regulators, rating agencies and the leading trade association, the Institutional Money Market Funds Association, generally consider five key criteria when establishing MMF guidelines: duration, credit ratings, instrument type, concentration and risk monitoring. These relate to the key risks faced by MMFs.

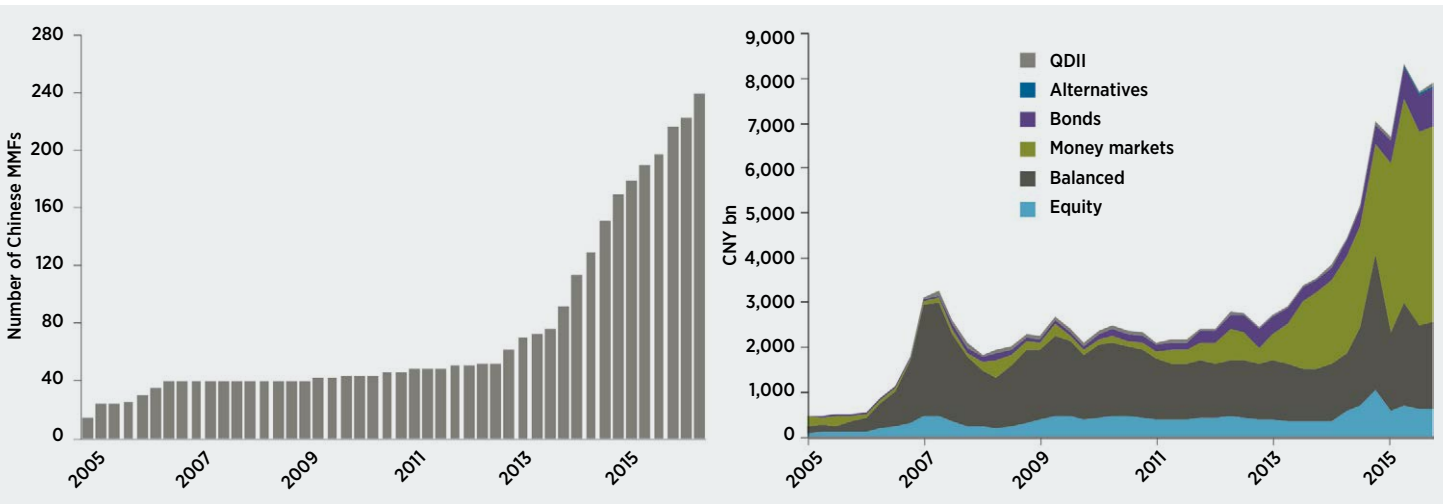
When the CSRC designed the first renminbi MMF guidelines back in 2004, it modelled them on Western guidelines. However, while the CSRC's original guidelines did reference the five key criteria for MMFs, the restrictions it imposed on the industry were relatively loose and interpretations of its guidelines were similarly relaxed. In short, fund managers typically focused on yield at the expense of liquidity and security.

More than a decade later, in December 2015, the CSRC unveiled new MMF guidelines that market the most significant rule changes in the industry's history.

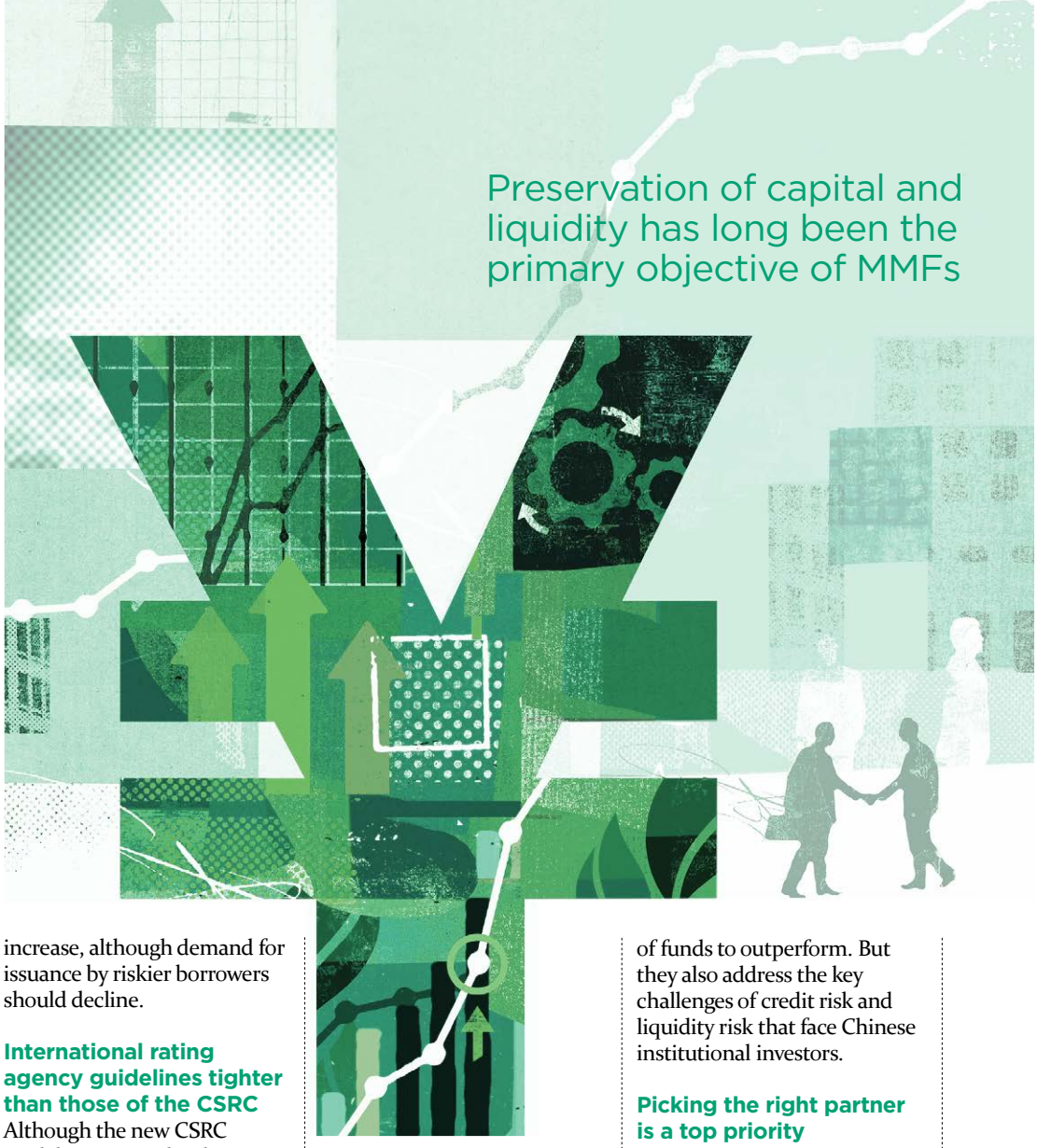
This latest iteration, which represents the most important and detailed change since the publication of the original guidelines, aims to make the MMF industry more robust, while minimising its exposure to systemic risks. This goal is especially critical at a time of increasing credit and liquidity risk.

Fund managers will have much less freedom to interpret this iteration of the CSRC rules. Although we expect a wider range of instruments and issuers in MMFs, fund managers are now more responsible for assessing the credit quality of issuers they purchase and for protecting their funds against adverse market movements. For investors, fund yields will be lower, but fund volatility will also decline. Meanwhile, liquidity, credit quality and disclosure will improve significantly. Trading volumes and demand for short-maturity securities should

FIGURE 1: NUMBER OF CHINESE MMFs AVAILABLE; CHINESE FUND INDUSTRY AUM



SOURCE: WIND INFORMATION CO LTD, JPMORGAN ASSET MANAGEMENT. DATA AS OF 30 JUNE 2016



IKON IMAGES

Preservation of capital and liquidity has long been the primary objective of MMFs

increase, although demand for issuance by riskier borrowers should decline.

International rating agency guidelines tighter than those of the CSRC

Although the new CSRC guidelines more closely resemble their Western counterparts, there is still a substantial gap between the two standards. This gap highlights the continued benefits of using tighter rating agency guidelines for investors whose priorities are liquidity and security.

The domestic AAA MMF guidelines offered by international rating agencies in China are still significantly tighter than the CSRC guidelines, while also taking account of the unique characteristics of domestic financial markets. These include relatively opaque monetary policy, unique instruments, such as stock exchange repo, and a more limited range of issuers relative to Western markets – all of which can have a significant impact on local market liquidity and volatility.

Under Fitch Ratings, for example, durations are shorter, concentrations are tighter, the range of approved instruments is constrained and credit quality limits are quite a bit stricter. These restrictions do limit the ability of funds to outperform. But they also address the key challenges of credit risk and liquidity risk that face Chinese institutional investors.

Picking the right partner is a top priority

Because of the persistent gap between the CSRC guidelines and those of the international rating agencies, it is especially important for corporate cash investors in China with stricter investment policies – prioritising liquidity and security over yield – to partner with the right liquidity solutions provider. The most effective partners have a deep understanding of the markets and will be able to react quickly to market, regulatory and client challenges impacting the short-term, fixed-income sector.

Conclusion: new horizons, new opportunities

The new CSRC guidelines represent an important milestone in what is still the relatively brief history of MMFs in China. In the dozen years since the industry was launched, MMFs have become a very important asset class, exposing investors to the benefits of interest rate liberalisation and market pricing, helping to broaden and deepen investment markets, stimulating new avenues of distribution and reducing the market's dependence on commercial banks. The proliferation of MMFs and the rapid growth of AUM underline their importance to both retail and institutional investors.

For institutional-focused funds with AAA ratings, the impact of the new guidelines will be negligible; that is because rating agency guidelines have significantly tighter restrictions. For the much larger retail MMF sector, the new guidelines will increase liquidity, while reducing credit and interest rate risk. They will also improve disclosure standards and encourage more proactive credit control by the fund manager. However, the rules will also negatively affect fund yields and the ability of fund managers to outperform their peers.

In sum, the latest iteration of the CSRC MMF guidelines delivers significant change. The new guidelines encourage a more robust investment process and address the key challenges facing China's domestic MMF industry. By any measure, that is no small accomplishment.

SYSTEMIC RISK

As the most significant and detailed change since 2004, the latest guidelines aim to make the industry more robust and less exposed to systemic risk – critical at this time of increasing credit and liquidity risk.

1 Source: CSRC, Order No. 78; data as of 2004
2 Source: Crane Data, ICI; data as of 31 December 2015

Aidan Shevlin is head of Asia Pacific liquidity fund management at JPMorgan Asset Management

J.P.Morgan
Asset Management

Strategies for Iran

POST-SANCTIONS IRAN REPRESENTS A COMPELLING COMMERCIAL PROPOSITION FOR MULTINATIONALS, BUT THEIR TREASURERS WILL NEED TO MEET INFRASTRUCTURE ISSUES AND RISK FACTORS HEAD-ON. SEMIH OZKAN EXPLAINS

Following the signing of a Joint Plan of Action (JPOA), a state of commercial hopefulness surrounds Iran. The immediate outcomes from the lifting of economic and trade sanctions have been: increased oil and gas production and exports, trade deals, the unfreezing of assets and, last, but not least, reconnection to the worldwide interbank financial telecommunications network.

Iran's oil and gas sector is the most obvious beneficiary of the post-sanctions era. The sector not only delivers around two-thirds of the country's revenue, but its restoration paves the way for foreign direct investments. In a relatively short period, the sector achieved pre-sanction production levels of nearly four million barrels a day and exports of two million barrels a day, well above the expectations at the time of the agreement, and a development that has helped Iran regain market share in Asia and Europe.

A wide range of foreign trade and direct investment deals, including a handful with US companies, were concluded following the lifting of sanctions. Iran also gained access to more than $100bn of overseas frozen assets. Meanwhile, SWIFT reconnected a number of Iranian banks, including the Central Bank, to its network, making financial transactions more transparent and economical for the country.

In light of these developments, Iran's central bank has said it expects GDP to rise above 5% this year. The International Monetary Fund similarly readjusted its forecast to around 4-5.5%. Clearly, the new era is expected to bring in significant economic benefits. However, the anticipated welfare is not much visible as yet. Economic benefits do not tend to spread evenly in state-led economies, and international companies are still proceeding with caution.

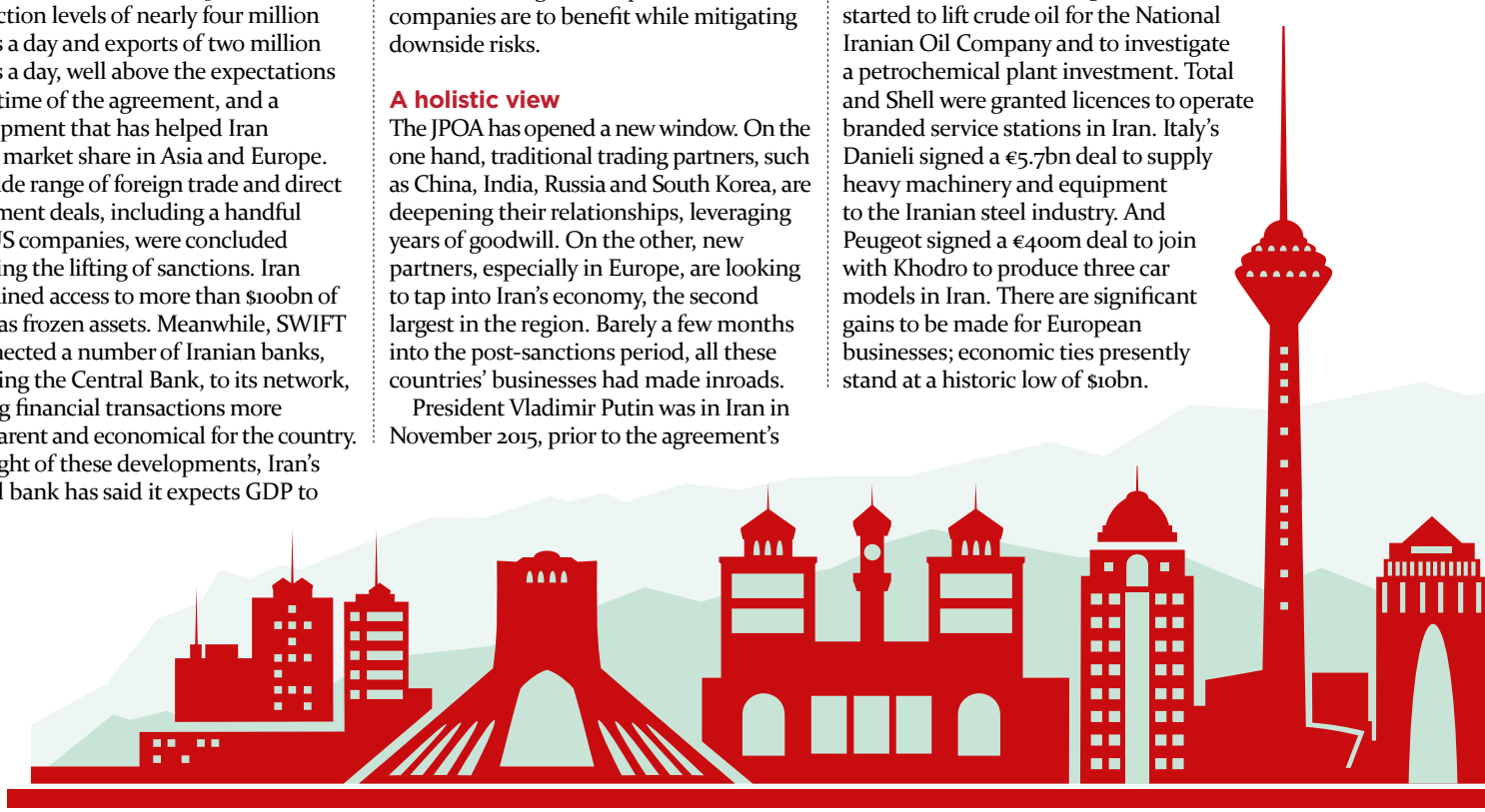
Corporate treasurers required to operate in this environment will have clear sight of the market potential, but no straightforward answers to help them navigate Iran's commercial landscape. They will need to take a holistic view and demonstrate significant patience if their companies are to benefit while mitigating downside risks.

A holistic view

The JPOA has opened a new window. On the one hand, traditional trading partners, such as China, India, Russia and South Korea, are deepening their relationships, leveraging years of goodwill. On the other, new partners, especially in Europe, are looking to tap into Iran's economy, the second largest in the region. Barely a few months into the post-sanctions period, all these countries' businesses had made inroads.

President Vladimir Putin was in Iran in November 2015, prior to the agreement's implementation, not only to develop $2bn worth of economic ties, but to investigate a new free-trade zone dialogue. The post-sanctions agreement period started off ambitiously with president Xi Jinping's visit, paving the way to a tenfold increase in bilateral economic relationships to $600bn over a decade. Following China's 'one belt, one road' visit, Iran's president, Hassan Rouhani, made progress in Europe, and inked a number of deals – most notably the €22bn Airbus deal, bringing Iran into the international civil aviation community.

At the same time, Saipem was contracted to restore the Pars Shiraz and Tabriz oil refineries for €3.5bn; both are essential to Iran's oil and gas sector. Total started to lift crude oil for the National Iranian Oil Company and to investigate a petrochemical plant investment. Total and Shell were granted licences to operate branded service stations in Iran. Italy's Danieli signed a €5.7bn deal to supply heavy machinery and equipment to the Iranian steel industry. And Peugeot signed a €400m deal to join with Khodro to produce three car models in Iran. There are significant gains to be made for European businesses; economic ties presently stand at a historic low of $10bn.



South Korea's president, Park Geun-hye, and Indian president Narendra Modi's visits coincided in May, and both were declared successful. South Korea intensified the recently eased economic relationships threefold to $18bn from $6bn, and India signed up to spend $500m to develop the geopolitically important Chabahar port.

And while ties with the US will remain challenging, Boeing and General Electric are scoping out deals.

A thorough analysis

When it comes to doing business in challenging territories, unemployment, underemployment and energy price shocks lead the list of top economic risks in the World Economic Forum's *Global Risks Report 2016*. Those are followed by the failure of national governance, fiscal crises, asset bubbles and cyberattacks. The Middle East region reflects similar patterns to the rest of the world, along with terrorist attacks and interstate conflict. Iran is no exception. The global risks are beyond the scope of corporate treasurers; however, they still need to ensure business growth, and continuity in the face of downside risks related to the JPOA, as well as country-specific challenges.

At present, Iran ranks 118th out of 189 in the World Bank's Ease of Doing Business index. Current regulations do not necessarily facilitate business. There is also room for more transparency; Iran ranks 130th out of 163 in Transparency International's latest report. And, Iran's overall infrastructure is ranked as average in the recent Logistics Performance Index – 96th out of 160, highlighting crucial need for improvement. Recent economic and policy developments around developing a diversified economy, progressing in science and technology, and promoting cultural excellence are helping to improve Iran's standing in these areas. Even so, doing business in Iran still remains a very complex and ambiguous task for corporate treasurers.

Businesses need to stay conscious of remaining sanctions and specially designated entities. The US dollar market is not accessible, but euro trade is, so businesses require an appropriate channel, depending on underlying base currency, to manage payments and collections. The global banking system, especially in Europe, is unclear on how to manage transactions allowed by the JPOA. Banks prefer to be reactive and impose enhanced due diligence for any corporate asking about payments and collection. Added to which corporate treasurers will need to manage regular business risks, such as credit, compliance, legal and political risks.

To operate effectively, corporate treasurers must prepare well-defined strategic plans. That should include comprehensive compliance details as well as risk and reputation assessments, exhaustive corporate intelligence, information on access to banking and FX, risk management and business continuity planning. Ongoing monitoring will also be essential to help treasurers navigate the evolving economic and political dynamics in the new period in Iran.

> The global risks are beyond the scope of corporate treasurers: however, they still need to ensure business growth and continuity

Patience

Even given recent positive economic and policy developments, the new period will not necessarily be straightforward.

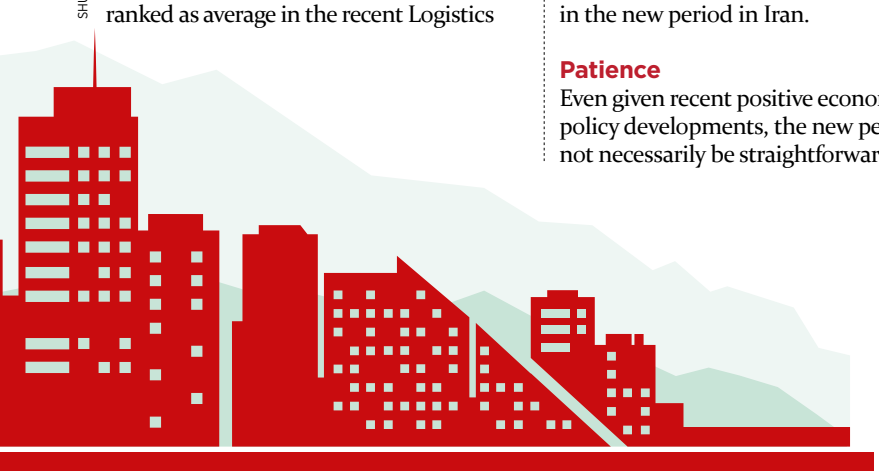
- There may be adverse reaction to strengthening ties between Iran and the rest of the world, perhaps even to the extent of one of the JPOA parties ceasing to perform its commitments under the agreement.
- While the oil and gas sector has seen immediate benefits, until more certainty and trust is generated, foreign trade and direct investment ties are likely to develop more slowly with sectors such as the automotive industry, airlines, pharmaceuticals, retail and banking.
- Iran's ability to capitalise on the new period also depends on its ability to continue structural economic and policy reforms. The latest efforts score well in improving doing business in Iran. However, the progress is gradual, and might fall short of corporate treasurers' expectations.
- While the financial sector's reconnection to the international financial system will help the sector to reduce transaction costs and bring in up-to-date technology and expertise, many international banks remain ambivalent when it comes to reconnecting with the Iranian banking system. Progress is likely to be slow, with limited options for straight-through banking services onshore.
- International companies, especially retailers, stand to benefit from Iran's acknowledged market potential. However, the expected harvest might take longer as the welfare does not uniformly and efficiently spread, and long-outstanding local brand associations do not break hurriedly.

Outlook

The post-sanctions period presents a powerful commercial and financial proposition for international companies. Some are already reaping rewards from signing deals early. However, the road to successfully unlocking those propositions will be uncomfortable. A long-term view, thorough analysis and a significant degree of patience are essential for corporate treasurers seeking to manage this balancing act.

This article first appeared in the Winter 2016 issue of *Middle East Treasurer*.

Semih Ozkan is an ACT student (CertITM) and a transaction banking professional in an international bank



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FX: POST-REFERENDUM DYNAMICS

FOR UK CORPORATES, FINANCIAL MARKET VOLATILITY HAS BEEN ONE OF THE FEW CONSTANTS BEFORE AND SINCE THE EU REFERENDUM. WHILE SOME MAY HAVE BEEN PREPARED FOR SHORT-TERM CURRENCY MOVEMENTS, A NEW MARKET ENVIRONMENT MEANS THAT TREASURERS MUST CAREFULLY RE-EVALUATE THE MANAGEMENT OF LONGER-TERM FINANCIAL RISKS, SAY YURI POLYAKOV AND ENRIC GIRONES

Whether or not they predicted the outcome of the UK's referendum on EU membership, the majority of corporates rightly anticipated significant market volatility post-vote. As such, they may have sought to mitigate financial risks ahead of time.

Those that were able to, ensured any funding deals were completed before June. Corporates also made sure that they had appropriate currency hedges in place – in advance of the EU referendum result. So while some companies may have been surprised by the outcome of the vote, not many felt immediate impact from FX movements.

Nevertheless, as sterling continually depreciated against the euro and US dollar following 23 June 2016, FX risk swiftly became a key agenda item for corporate treasurers. In fact, a survey conducted among Lloyds Bank's corporate clients over the three-week period after the referendum result saw 35% of respondents cite FX market levels as their top concern (see figure 1, below).

No level playing field

Several months on from the EU referendum, these FX market levels continue to move and are proving challenging for some UK corporates. Those most heavily impacted by the pound's depreciation are, of course, importers whose costs are mainly in euros or dollars, and whose revenues are in sterling. Retailers, travel companies and supermarket suppliers have been among those sectors adversely affected.

Conversely, UK exporters whose revenues are in euros or dollars, and costs are in sterling are benefiting from the weak pound. In addition, a weaker sterling tends to make UK exports more attractive to overseas buyers, potentially leading to increased revenues from both existing and new customers.

This split impact has led to contrasting financial risk management strategies being deployed in the wake of the EU referendum. While importers have seen the benefits of being hedged through the period, they are understandably reluctant to lock in current unfavourable rates and are conservative about extending their hedges. Some importers have even reduced the tenor of their existing hedges, in line with the parameters of their treasury policy.

Other importers, whose treasury policy allows a level of flexibility around the choice of hedging instruments, have purchased more option-based instruments, where previously they had used forward-based strategies. Meanwhile, a number of exporters are also benefiting from a flexible treasury policy and have extended their hedges in order to lock in favourable rates for longer.

The road ahead

But for those treasurers who are yet to revisit the majority of their hedges post EU referendum, including those who have little flexibility in their treasury policy, deciding what to do once current hedges start rolling off is becoming increasingly important. Determining the appropriate hedging instruments and horizon for new hedges can be complex, in particular given the volatility in the FX market, which is expected to persist as the UK's negotiations to leave the EU progress.

Longer-term hedging decisions are made even more challenging by the uncertainty surrounding the future business environment. Some corporates are currently in 'wait and see' mode – still wondering how the UK's trade negotiations will unfold. Whichever route is chosen, it is likely that the rules of engagement for UK businesses trading with Europe will shift. This may result in changes

FIGURE 1: KEY RISK ISSUES FOR CORPORATES

% of client responses	Cited concern
35%	FX market levels
26%	Economic slowdown impacting business demand
12%	Changes in trade/regulation/tax rules
11%	Funding and liquidity
7%	Mark to market

THE ANALYSIS WAS CONDUCTED BY LLOYDS BANK OVER A THREE-WEEK PERIOD FROM 24 JUNE 2016 TO 15 JULY 2016, FOLLOWING THE ANNOUNCEMENT OF THE EU REFERENDUM RESULTS. THE CLIENTS SURVEYED COVERED A RANGE OF ORGANISATIONAL SIZES (FTSE 100 TO SMES) ACROSS DIFFERENT SECTORS

in tariffs, for example, which would then impact margins even further.

Consequently, UK corporates with strong trading links to Europe not only need to prepare for operating in a new FX environment, but a new business environment, too. The challenge is how to do that effectively with such limited visibility of the direction and progress of the UK's trade negotiations.

Test your assumptions

Stress testing the business model can be a good place to start. By conducting scenario analysis, corporates should be able to gauge what the future business environment might look like, and what is the impact of exposures and risks they may face.

In turn, this should enable them to better determine whether, and how, they need to adjust their long-term business strategy in order to survive or thrive in the new environment. After all, not every risk can be mitigated by financial instruments – fundamental changes in the way the business operates may also be necessary.

Such changes might include rethinking investment plans if certain markets become more, or less, profitable. Importers might also be looking across the board for cost-reduction solutions. These may include switching suppliers, changing raw materials or improving the working capital cycle to benefit from early-payment discounts. Some may also look to begin passing costs on to their customer base, or absorb the FX hit in their margins where possible.

No matter which business model changes are adopted, it is important to ensure that the company's hedges will still be effective in this new environment. Corporates can evaluate the effectiveness of their hedges by overlaying these onto their exposures when performing stress testing.

Time to act

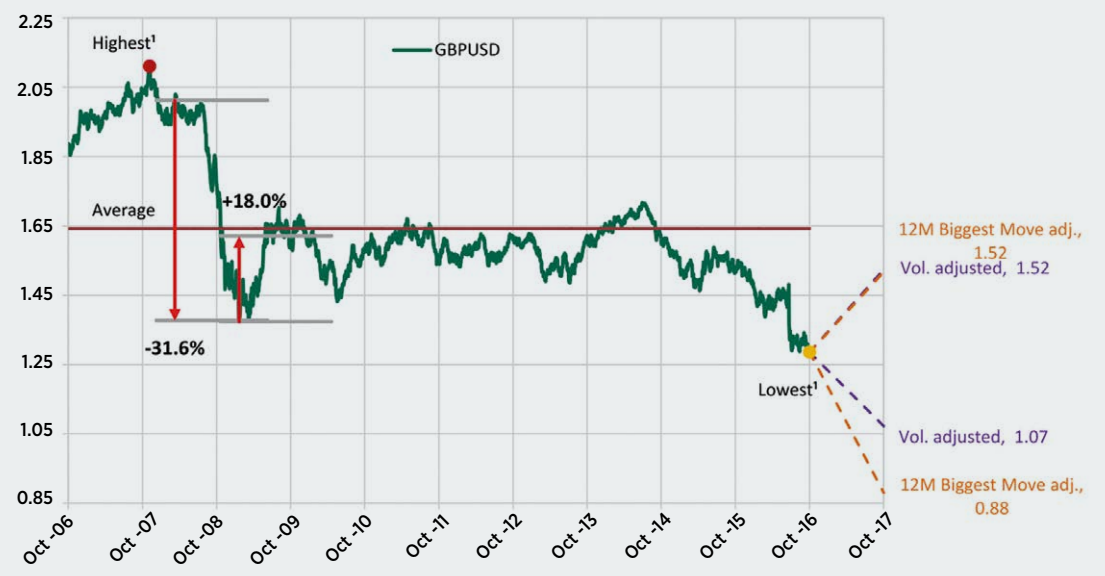
Firms can combine both backward- and forward-looking measures when designing their stress scenarios. When examining the historical behaviour of a risk factor, the largest adverse and favourable move over a certain horizon (for example, 12 months) can be identified (see red arrows in figure 2). These relative moves can then be applied to current levels to build history-based stress scenarios (see orange paths in figure 2).

Alternatively, market-implied volatility can be used to build an interval around the future value of a risk factor (see purple paths in figure 2). These stress scenarios can then be used by corporates to better understand the impact that adverse financial markets may have on their net asset values or earnings.

However, implementing changes to financial risk management strategies may take longer than anticipated. Building flexibility into a treasury policy and getting that approved by the board can take time. Likewise, setting up lines with banks, and putting the appropriate derivatives documentation in place, if a company has not previously entered into a master agreement with their bank, can limit the speed at which changes can be made.

By starting to think about their future hedging needs now, corporate treasurers should find themselves better equipped to react more quickly to market movements. What's more, actively reassessing hedging needs not only demonstrates best practice, but also provides an excellent opportunity for the treasurer to make their voice heard in the organisation and showcase their value as a strategic partner to the business.

FIGURE 2: EVALUATING MARKET-BASED STRESS TESTS



THESE STATISTICS HAVE BEEN CALCULATED FROM THE FOLLOWING DATE RANGE: 3 OCTOBER 2006 TO 3 OCTOBER 2016. SOURCE: BLOOMBERG DATA AND LLOYDS BANK ANALYTICS WITH DATA AS OF 4 OCTOBER 2016. PAST PERFORMANCE IS NOT A GUARANTEE OF FUTURE RESULTS

FINANCIAL RISK MANAGEMENT: A STRUCTURED APPROACH

The result of the EU referendum has clearly done much to focus the minds of treasurers on financial risk management. But regardless of the market environment, treasurers may benefit from implementing the following cycle when it comes to determining optimal strategies for managing financial risk:

1. Examine the business model and growth strategy, and identify your current and future exposures/risks.
2. Understand the impact that these exposures/risks may have on your KPIs.
3. Assess the effectiveness of your risk management strategy in achieving your objectives (for example, minimising KPI volatility).
4. Frequently review and control the effectiveness of your hedging strategy (product mix, tenor and structure) to achieve your desired objectives.

Yuri Polyakov (left) is head of financial risk advisory; and **Enric Girones** (right) is associate director, financial risk advisory, at Lloyds Bank

LLOYDS BANK

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THE RACE TO THE OVAL OFFICE

AS THE US PRESIDENTIAL CONTEST GROWS MORE HEATED, THE OUTCOME BECOMES MORE DIFFICULT TO CALL. WHAT IS CLEAR, HOWEVER, IS THAT UNCERTAINTY IS THE ORDER OF THE DAY, ESPECIALLY IN CURRENCY MARKETS. THOMSON REUTERS' CORPORATE TREASURY TEAM EXPLAINS WHY CORPORATE TREASURERS NEED TO PLAN FOR ALL SCENARIOS

In just a few days, the US presidential election will reveal the new leader of the world's most influential economy. Given that a Democratic government has been in control since 2009, many forecasters argue a Hillary Clinton victory will have a milder impact on the political and economic climate overall than a Republican win. That said, with Clinton recalibrating her position on tax, spending and trade, there is still a measure of uncertainty.

If Donald Trump wins, some are concerned that his lack of political experience means he might not ease into government as smoothly as Clinton. His supporters argue that his strong business acumen could give the US economy a shot in the arm.

At this point, it looks like a Trump win could bring about a more obvious policy shift. This could precipitate short-term fluctuations in US dollar markets. However, these effects could fade as soon as his policies prove to be successful – or could grow should the opposite transpire, commentators suggest.

Trade

While Clinton originally referred to the Trans-Pacific Partnership (TPP) as the "gold standard" in trade agreements, she came out in opposition to it when negotiations wrapped up. Traders are likely to wait for clarity on her position before making any decisions here.

Under Trump's trade policy, the North American Free Trade Agreement and the TPP will be revisited and higher tariffs may be applied to Mexico and China, with the goal of stimulating domestic manufacturing, according to commentators, such as IG Index. If growth is affected when trade ties are cut, investors could cut their exposure to US equities and the dollar. Alternatively, Trump's stance could see the dollar rise as investors liquidate their foreign (riskier asset) holdings. Concerns that Mexico's exports to the US could be threatened have seen the Mexican peso hover near a historic low of 20 to the dollar. However, the peso's ties to the oil price and Mexico's credit-rating woes could also be contributing factors.

As the future of global trade hangs in the balance, International Monetary Fund managing director Christine Lagarde announced a downgrade to the US growth forecast and warned against trade restrictions.

Tax

Under Clinton's tax plan, capital gains will be subject to increased duties, there will be a surtax on income over $5m and corporate tax loopholes will be closed. Analysts at IG Index expect these stringent measures to be reflected in the Dow and other indices.

Trump's tax plans could see revenues fall in the short term. He envisions halving corporate tax and reducing income tax brackets from seven to three, freeing 75 million households from paying tax and cutting the top-tier maximum from 39.6% to 33%. This could boost domestic investment, lifting the dollar and key indices.

Spending

According to the Committee for a Responsible Federal Budget's most recent report,[1] "Clinton's plans would increase the debt by $200bn over a decade above current law levels (compared to our prior estimate of $250bn), and Trump's plans would increase the debt by $5.3 trillion (compared to our prior estimate of $11.5 trillion)." It's

important to note that this is a rough and preliminary report.

The first Clinton-Trump debate

Forex traders decided Clinton won the first debate. The US dollar and Mexican peso enjoyed a bump in the aftermath, as gold prices dipped and the safe-haven yen weakened. According to analysts, these moves suggest that Clinton came out stronger in the round. "From a market perspective, rightly or wrongly, there is an understanding that Mrs Clinton would be a safe pair of hands," Brad McMillan, CIO for Commonwealth Financial in Massachusetts explained.[2]

While US presidential elections are not normally major market movers, this year's election shaped up as a highly unusual contest with substantial implications for the economy and financial markets, particularly FX. History suggests that markets respond better to elections when the outcome is predictable. Yet throughout the debates, uncertainty was the prevailing sentiment – and we all know that markets hate uncertainty, as evidenced by the direct impact to US dollar currency market sentiment on both FX and gold markets.

A Trump victory could very likely mean more alterations in foreign policy and trade, and presumably marked changes in American politics. This, in turn, could insulate the US from its trading partners and have an effect on exports. It could also see immediate, but short-term, fluctuations in the US dollar markets due to the uncertainty about the effects of Trump's policies on the US economy.[3]

Adding to this market trepidation is the possibility of a Federal Reserve interest-rate increase. The Fed's recent decision to keep a hike on hold despite solid domestic performance weakened the dollar, which lifted commodities. Metals were up across the board, according to Marketwatch.com.

Fed chair Janet Yellen noted that a hike could come by the end of the year, but for now, the economy has "a little more room to run". The Fed assembles again just a few days shy of the election. Most economists believe that rates will stay put until after the election – partially due to a 'wait and see' approach, but predominantly as a response to sluggish global growth and a focus on reaching maximum employment targets.

While the Fed calls the shots on monetary policy, decisions made by the new president will affect political and economic stability, with a substantial influence over the dollar.

It's difficult to predict what will happen as the race towards the Oval Office continues to wag currency markets

Managing market volatility

From the point of view of corporate treasurers and financial executives, it's essential to have robust strategies in place alongside the analytics and solutions needed to give a clearer view on how to manage FX and liquidity risk more efficiently. This race could still go either way; and it's prudent for treasury to prepare for all outcomes.

Forex

Looking at the recent EU referendum, the British pound fell against the US dollar by 14% after the Leave vote – recording the sharpest two-day dip by any major currency since 1973. While it's difficult to say whether the dollar could plummet this low after the US election, with either candidate winning, the dollar is likely to drop initially to some extent. Amid uncertainty, investors are likely to take flight from the dollar in favour of more stable global assets.

That said, the US dollar does not always react in the same way as other currencies. In times of turbulence, this safe-haven currency can actually strengthen as investors become concerned about the impact on the global economy as a whole.

On a corporate level, increased dollar volatility could pose varying challenges for treasurers, depending on the nature of their international activities. Firms that export to the US could see their cash flows being hit by their heightened FX exposure.[4]

This is a time for treasurers to monitor the currency markets carefully – especially currency pairs like GBP/USD, USD/JPY and EUR/USD – to facilitate well-versed decisions around the best timing for transfers.

Precious metals

Gold, like any safe-haven asset, responds to ecopolitical upheaval. Brexit saw gold rising by $60-80 per ounce before levelling out in the $1,300s. This price could fluctuate again around the US election.

Uncertainty after a Trump victory could lift the gold price; whereas Clinton as president could see gold prices losing ground as the risk premium falls (unless, of course, the Republicans gain control of the Senate).

Specific policy changes, from either candidate, could impact metals more broadly. For instance, if the winning government foregoes the TPP and Transatlantic Trade and Investment Partnership (TTIP), the US could potentially relinquish market share in the precious metals scrap industry.

The way forward

It's difficult to predict what will happen to markets across the globe as the race towards the Oval Office picks up speed and continues to wag currency markets. Corporate treasurers, therefore, need to adopt a more vigorous risk management mindset when choosing execution strategies and processes, as well as analysing which currency hedges to use.

It's important to understand the underlying risks of FX rates and how to measure them before deciding on a hedging strategy to reduce volatility. It's also essential to analyse market pricing to uncover the most cost-effective hedge structure, as well as stay abreast of relative liquidity during the day.

Hopefully, the US election year may just cause a few bumps in the road rather than a complete change of course for the US dollar and world economy.

1 www.crfb.org/papers/promises-and-price-tags-preliminary-update
2 www.reuters.com/article/us-global-markets-idUSKCN11X012
3 www.currenciesdirect.com/en/uk/news/us-election-2016-will-this-affect-the-usd
4 www.treasurers.org/node/324733

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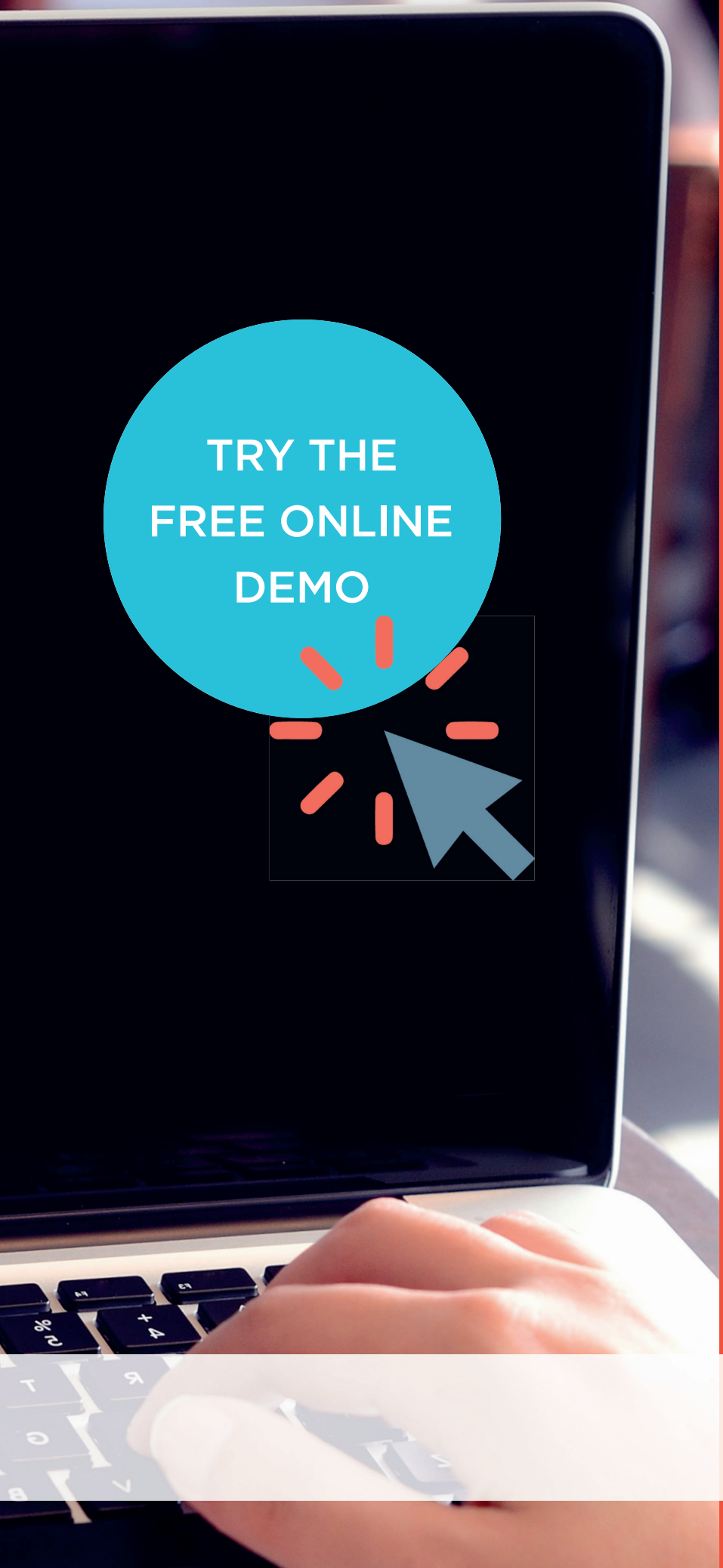

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LAYING A PATH

SILK ROAD BONDS COULD BECOME ANOTHER KEY ASSET CLASS AS CHINA REACHES OUT TO THE WEST UNDER THE ONE BELT, ONE ROAD INITIATIVE. WARUT PROMBOON EXPLAINS HOW THEY DIFFER FROM OTHER ASSET CLASSES IN STRUCTURE AND RISK

Silk Road bonds could be an innovative capital market solution with the potential to benefit a vast number of people in Belt and Road countries, many of which have been previously ignored by the international bond market. Their development will help spur the economy not only of China, but also other countries along Belt and Road routes, a win-win for global trade and for poverty reduction. At the same time, there is a need for third-party verification for this new asset class and perhaps an external support mechanism to ensure investors can assess the risk versus return trade-off.

Definite concept needed

Silk Road bonds could offer investors both portfolio diversification into other Belt and Road countries, and extra yield in exchange for lower liquidity and longer tenor. However, first and foremost, the concept needs to be clarified by the investment communities and governments of the Belt and Road countries, especially China. As yet, there is no single concept for Silk Road bonds.

In our view, Silk Road bonds could come with an additional support mechanism and, in order to ensure the mechanism is in place, a definite concept that everyone agrees on is badly needed. The concept should not be too rigid, so as to allow for flexibility in structuring the new bonds, but it needs to be sufficiently clear to prevent exploitation of the additional support mechanism.

In general, the Silk Road bond concept should entail the use of proceeds to fund infrastructure projects along the Belt and Road routes. Silk Road projects will need to be defined, and proposers should also indicate the anticipated benefits to Belt and Road countries. In that sense, a ratio of economic benefits to the country where the project is situated to economic benefits to other Belt and Road countries could be a good indicator of overall value. Dagong is a member of a working group, organised by the International Capital Market Association, working with many market participants to establish a Silk Road bond concept.

Multiple countries of risk

Proposed Silk Road routes take in many different territories and, as a result, there are two key credit considerations. First, given the diverse territories, there could well be multiple levels of risk, all of which will form the operating environment for Silk Road bond issuers. Since infrastructure projects will likely be supported by central governments, a lack of country knowledge and the complexity involved in evaluating multiple countries could prevent credit analysts from assessing the level of external support those projects might receive. Another issue is how well the investor community will be able to gauge the level of mutual support of countries along the Belt and Road routes. Simply speaking, a failure to pay in one country could affect subsequent projects in other countries along the routes, so the

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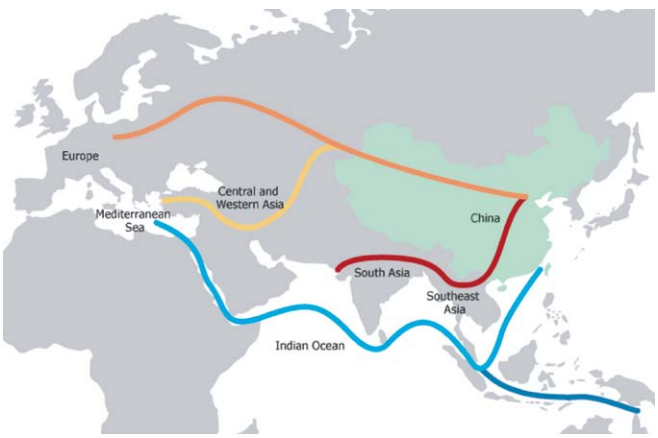
Belt and Road routes



SOURCE: HONG KONG TRADE DEVELOPMENT COUNCIL

existence of mutual support will be critical.

Second, investors may lack knowledge of some of the countries along the routes and, in fact, these countries are likely to be the ones that most need new infrastructure in the first place. Many Belt and Road countries are not very well known to investors and the majority of the Belt and Road countries are classified as high risk by the investment community. Despite the fact that only two out of 65 countries along the Belt and Road routes are not rated by any major international rating agencies (Iran and Turkmenistan), many countries do not have a presence in the international bond market. The median and average GDP per capita of Belt and Road countries were $5,496 and $10,402, respectively, according to the latest information from the World Bank, both low compared with those of many developed countries.

Secured bonds

Potentially, Silk Road bonds could be secured with assets such as infrastructure projects. To properly gauge the credit risk of secured bonds, credit analysts will need to understand the recovery rate of these assets. The subsequent issue would be whether a project will be a brownfield or greenfield project.

For a brownfield project or a project in operations that already generate cash flow, investors may not have a reliable default history, recovery information or tested bankruptcy procedures in many of the Belt and Road countries. For a greenfield project, or a project either under construction or a project that has not started construction at all, project finance will require experts to look into a project's future cash flow. We believe independent third parties (ie credit rating agencies) could come in to study underlying assets so that investors can properly assess the recovery rate of the bonds.

External support mechanism

We believe one of the solutions for difficulties in assessing multiple countries of risk and unfamiliar underlying assets is a credit enhancement, ie a guarantee or a wrap, either from a government or commercial banks (in the form of standby letters of credit).

Long tenor

Silk Road bonds' tenor could be long, ie 10 years or more, as Silk Road bond proceeds could be used to fund long-term infrastructure projects. A longer tenor makes external support in terms of guarantees by multilateral organisations problematic, in our view.

Multiple regulatory regimes

Silk Road bonds can be listed in multiple countries and under different regulatory regimes, especially multiple Belt and Road countries. Every Silk Road bond could carry different disclosures, accounting standards, laws and languages. In addition, investors may not have access to some markets, which will make some Silk Road bonds less liquid.

Different accounting standards mean foreign companies could be discouraged from issuing Silk Road bonds in a country where they need to convert their accounting standards (as in the case of Panda Silk Road bonds, where issuers would need to provide financial statements according to Chinese Accounting Standards).

Silk Road bonds could offer investors portfolio diversification into other Belt and Road countries

Extra features

We believe many Silk Road bonds will come with extra features, such as sustainability (ie Green bonds) and/or Sharia compliance (ie Sukuk bonds). These features are compatible and can overlap. So there could be Green Silk Road bonds, Sukuk Silk Road bonds or even Green Sukuk Silk Road bonds. The Chinese government is committed to the growth of the Green bond market. Likewise, the new Silk Road covers many Islamic countries and we would not be surprised to see Sukuk Silk Road bonds marketed to Islamic investors.

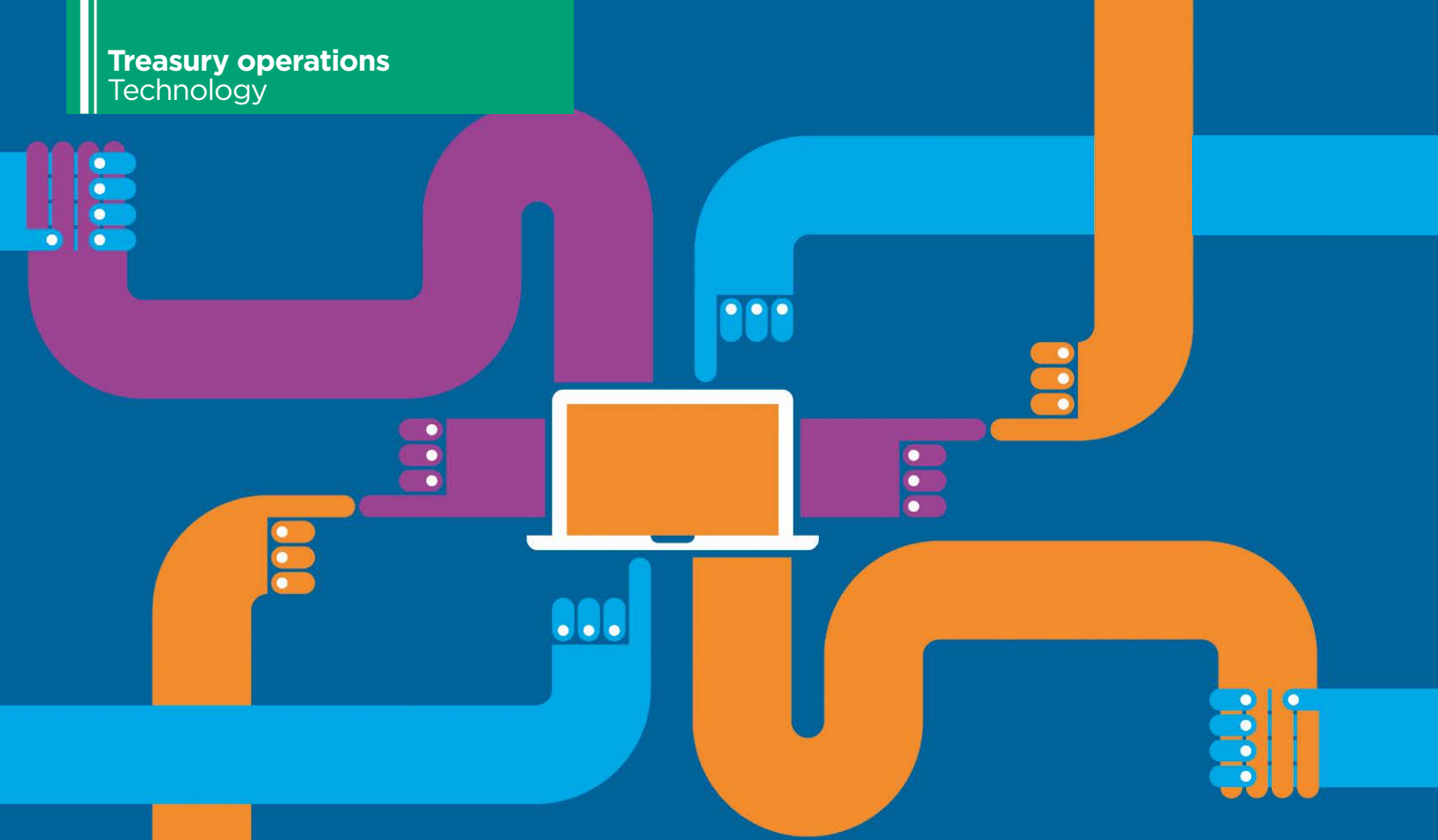
Certification

We believe all of the above unique features could necessitate Silk Road bond certification by third parties. In fact, third-party verification may be needed from the outset to certify whether Silk Road bond proceeds are genuinely to be used to fund Belt and Road countries, and whether a project is qualified as a Belt and Road project.

Finally, investors will need to be able to differentiate credit quality among Silk Road bonds. In general, investors carry out credit due diligence through credit ratings and credit research. The former relies on local and international rating agencies, while the latter relies on in-house credit teams, asset managers and/or sell-side research houses. We believe that we need sufficient rating coverage for Silk Road bonds, as dedicated in-house research could take time to be built up. However, we expect the availability of research and ratings on Silk Road bonds to grow in tandem with the rising demand and supply of Silk Road bonds.

In conclusion, we believe Silk Road bonds are here to stay, but there are a few loose ends that major governments along the Belt and Road routes, together with the investment community, must work on together. A simple form of government-guaranteed project bonds, of which proceeds will be used to invest along the Belt and Road routes – could be a useful first step to draw more investor attention. We believe that there is liquidity waiting to be deployed and that investors are ready for this new asset class.

Warut Promboon is chief rating officer at Dagong Global Credit Rating Ltd in Hong Kong



A case for change

INVESTING IN TREASURY TECHNOLOGY SHOULD BE A NO-BRAINER. BUT ARE YOU AFTER STABILITY OR DO YOU WANT AN AGILE SET-UP THAT WILL FUTURE-PROOF THE FUNCTION? CARL SHARMAN SETS OUT THE CASE FOR BOTH

Treasury technology can be complex, both for the treasury function – who are not IT experts – and for the IT team, who are not treasurers. Multiple and fragmented technologies, including treasury management systems, bank and trading software, and valuation and communication services, coupled with the speed of change and emergence of new trends, have made the landscape increasingly difficult to understand and navigate.

Nevertheless, who wouldn't want to 'push a button' with simplified, bespoke and integrated solutions to consolidate and standardise processes and reporting? Yet treasury remains a complex discipline, unique to business and sector, and making decisions on when, where and how to invest are not easy.

Creating a case for investment

The most important question is: what will new technology add to treasury's capability? As a starting point, you will need a solid and tangible business case for investment. Most corporates will face constant challenges from within to deliver year-on-year cost savings and this can only be achieved by looking at new ways of doing things.

In any business process, if you keep doing the same things, then at best you will get the same results. If you keep doing the same things in a fast-changing environment, your organisation may suffer severely from increasing regulatory requirements, potential errors and security and fraud issues.

Choose your priorities

Recent developments have required treasury to prioritise risk reduction and improve access to liquidity, as well as find cost-efficiencies. This highlights wider enterprise risk concerns, including counterparty risk management, cash visibility and liquidity access, cash-flow forecasting, real-time reporting, IFRS 9 and other financial reporting and governance needs. Compliance and regulatory change can provide a persuasive case for investment.

Once expected benefits have been mapped to these objectives, the risks in not making the technology investment can overshadow financial cost savings. Making suboptimal financing decisions or not being able to provide timely financial reports could cost your organisation more than the cost of the capital investment in technology.

Think broader

Technology-led transformation needs excellent planning to realise its potential. 'Out of the box' rarely works. Begin with the end in mind, and you are more likely to benefit from broader business change. Think broader again to reach for more: how many steps might your new technology eliminate from your current processes? How much more quickly would that enable you to deliver insight?

IKON IMAGES

Think broader to reach for more: how many steps might your new technology eliminate from your current processes?

How much of an edge will these factors give you in terms of performance, and how can these be demonstrated as providing value to the business as a whole?

This is one of the best outcomes of new technology solutions: not only can they help you do what you currently do better, but they can also enable you to expand in new directions.

Cost of delaying

In examining real costs and whether there is an appetite to invest, you also have to consider whether you can afford not to invest. The common challenge for investment is to find ways to reduce costs or save time. Technology that delivers either – or both – of these will give you an edge, which in turn could lead to better judgement, accuracy and certainty that more than justifies your investment. How 'algo' can and should your treasury function become? You need to identify the costs to your business of not investing in new technology.

Making the case

There are a number of quantitative business benefits that can be identified, ranging from 'hard' (reduced hardware/licence costs, headcount reduction) to 'firm' (increased productivity through process improvement) and 'soft' (better reporting accuracy).

Traditionally, one of the most common business case problems in treasury has been quantifying the hard benefits. With treasury teams small in number, the headcount savings are rarely evident. So it is critical to articulate clearly the softer benefits – such as real-time reporting or more accurate cash forecasting – and the business value that they bring.

People make decisions based on intangibles as well as tangibles. Always include qualitative benefits as a potential deal clincher.

Flexibility and a bi-modal approach

The programme must be flexible enough to be future-proof and a 'bi-modal' approach will help link the current landscape to the desired end state. Mode 1 targets *stability* in getting the most from existing core system effectiveness. You are likely to have an existing landscape and ways of working. Maximising this will appeal to the budget holders.

Mode 2 focuses on *agility* and ongoing investment in development, innovation and change. Using the latest technology in innovative ways, or being at the leading edge, is unlikely to be a smooth process because there is less experience available to guide you. The complexities of getting layered products to work together with your core system and be 'right first time' can be costly without access to a combination that has been developed, tried and tested in practice elsewhere.

Implementation basics

Strong project management is the key driver of implementation success and can overcome budget constraints, overburdened staff, scarcity of resources and tight timelines. Key stakeholders need early identification: who is currently experiencing the 'pain'; who will provide input during the project; who will benefit; who needs to approve the project; who will be accountable during the implementation, and so on. Accountability instils responsibility.

Identifying core implementation roles is also essential, including those who can identify and solve problems as they arise; those who have subject matter expertise; those who possess the seniority to allocate internal resources and those who have the capability to oversee the vendor relationship and keep the project on track.

Requirements must be prioritised and aligned to the budget provided, and the complexity of each must be understood. Different platforms and feeds may be in scope, including market data, trading, banking, various forms of enterprise resource planning (ERP) and middleware. Whichever areas are targeted, a clear critical path is needed, and interdependencies must be tracked.

Deeper ERP integration, increasing automated transaction posting and reconciliations, insight and intelligence analytics, mobile and digital developments, and even a shift to hosted or outsourced support could evolve within the implementation timeframe, as benefits are seen and realised.

Keep learning

Finally, having taken the leap of faith and invested in the technology that you hope will take your treasury function forward, it is vital at each step to analyse what is working, what isn't and what you can learn for next time. The pace of change in treasury technology means no investment should be considered as a one-off. Realistically, any investment you make needs to be viewed as the start of a rolling programme. This positions your treasury function to think as a market innovator, or at least as a fast follower, that is open to keeping pace as products and services evolve, from cybersecurity to biometrics, predictive analytics to robotics, and even blockchain.

A technology-led change project can also be a great way to motivate your people. Developing a shared vision of a new technology and process landscape, and then sharing the highs and lows of delivering it, can pull together a bonded, agile new team.

A question of how far to go

Technology should encourage the right balance of releasing people from transactional work while maintaining an optimised control environment, becoming more algo and performing more value-adding activities. How much of your treasury waterfront can it cover, and how agile is it to respond to change? A well-thought-through approach and process of continual improvement could even remove the need for a button to push – as it requires someone to decide to press it.

'Do nothing' is no longer a viable option: not only will it entail missing out on improved efficiencies and lower costs, but failing to consider emerging technologies in your landscape could mean losing competitive advantage or – worse – unacceptable operational and reputational risk for the organisation.

Carl Sharman
is head of treasury technology advisory at Deloitte

AGE OF ALGORITHMS

IF TREASURERS ARE TO MAKE THE MOST OF EMERGING TECHNOLOGIES, IT'S TIME TO DEMYSTIFY THE ALGORITHM. LESLEY MEALL EXPLAINS

Unless you are living on a remote planet in a galaxy far, far, away, you have probably used a computer to interact with an algorithm at some point today. You use face-detection algorithms when you tag somebody on your mobile phone; you expand the scope and range of algorithms when you make an online purchase or access a cash machine; you allow algorithms to make decisions on your behalf when you check your email (and don't look at what's been diverted into the spam filter).

Hype around how Facebook, Google and others are using search and self-learning algorithms can make it seem as if every algorithm is cutting edge. It is not. An algorithm is any specific method, process or set of rules that can be used to complete a clearly defined task, which could be processing data, solving a problem or achieving a goal. Self-learning algorithms take things to another level and *The Treasurer* recently explored the implications for the future of treasury roles (see www.treasurers.org/node/322545). See also the ACT blog at https://blogs.treasurers.org/whats-on-the-horizon-for-treasurers

The potential of 'smart' self-learning algorithms is massive. At Essex University, Professor Maria Fasli is using multiple, goal-oriented, self-learning algorithms called agents to analyse big data on the behaviour of the massive and complex FX market: extracting patterns of behaviour, formulating hypotheses to explain them, developing simulations to test these and then refining them to the point where they can predict the behaviour of the market.

Get smart

"Traditional software applications need to be told explicitly what it is that they need to accomplish and the exact steps that they have to perform. Agents need to be told what the goal is, but not how to achieve it," says Fasli. Being smart, they actively seek ways to satisfy this goal, reacting to changes in the environment as they occur, then modifying their course of action to accomplish their goal. "We will increasingly be delegating tasks and goals to such systems and interacting with them," she predicts.

Many of us now depend on rule-based algorithms, personally and professionally. "They are already in use in cash pools, zero-balancing pools, notional pools, cash concentration and that sort of thing," says Sanjay Bibekar, treasury technology lead at PwC. With cash concentration, for example, software uses algorithms to ensure that sub-accounts have a constant/zero balance and that debit and credit balances are automatically physically swept into the concentration account (when local regulation allows).

Banks and treasury management system (TMS) developers have been using algorithms for years to offer the cash management functionality in their products and services. There is nothing new about software programs that enable treasurers to complete tasks more efficiently and effectively

with the help of algorithms. Most of the time we use them without thinking about this; particularly when we are not alerted to their presence by the names of products and services and practices, such as algorithmic trading.

Look beyond the hype

As algorithms have become part of popular culture and everyday language, it can seem as if they have also been endowed with near-mythical powers, but the widespread focus on cutting-edge applications can be misleading. Computer-based trading strategies (such as high-frequency trading), which are supported by algorithms, may grab the headlines; nonetheless, numerous treasurers are using algorithms to help them to solve everyday problems and manage core treasury processes.

This does not demand the latest technology or specialist software, though such tools can help. Once you have devised a method (aka algorithm) to complete a task, you can use productivity tools such as the spreadsheet Microsoft (MS) Excel and other software applications in the family (such as Outlook and Word) to automate this. "I write Visual Basic routines that create reports, move data around and feed it into other systems," says interim treasurer Chris Fell.

Treasurers who are not on first-name terms with the formulas and functions in MS Excel, or able to programme using Visual Basic, may be surprised by what Fell can achieve. "I have a spreadsheet database for FX trades, then a routine that takes the most recent line on that spreadsheet, posts individual data points into a Word program, which then produces a confirmation for matching and signature," he explains. Fell also has a routine to move data from Excel into Outlook, where he has set up a maturity ladder.

Like all treasurers, Fell is focused on risk and is keen to highlight the potential strengths of an off-the-shelf TMS. "I tend to work in sectors where transaction values are high and volumes are low, such as real estate and mining. A TMS is more effective when there are many more deals or you are operating an in-house bank," he says. Lack of control may also be an issue. "If somebody makes a mistake, they can make it look as if they didn't, by editing the spreadsheet. With a TMS, data is more secure and you have an audit trail."

It may be a mistake to allow your aspirations or achievements to be limited by the overblown hype that surrounds self-learning algorithms, or to become distracted by differences of opinion and interpretation around the associated language. "When it comes to drawing lines between terms of reference like analytics, algorithms and data science, there's a lot of semantics involved," says James Murray, who specialises in this area at the recruiter Robert Walters.

> "Traditional software applications need to be told what it is that they need to accomplish and the steps that they have to perform. Agents need to be told what the goal is, but not how to achieve it"

> An algorithm is any specific method, process or set of rules that can be used to complete a clearly defined task, which could be processing data, solving a problem or achieving a goal

This need not be a barrier to exploring rule-based treasury use cases. For example, analysing bank charges, comparing them with the rate card and determining whether you are paying the least you could for them; managing credit and risk analysis of cash and liquidity across multiple cash investment strategies; optimising the control, timing, price and execution of currency orders. FX is an area where banks are already helping corporates to explore the benefits.

Think big

For example, a large corporate can control the execution and risk of a strategy to buy currency for one large (and material) transaction, with the help of rule-based algorithms. By using bank infrastructure that enables it to: split its currency purchase into small trades; define the start and end time for the strategy and the conditions affecting this; limit the maximum strategy price by setting the frequency and timing of trades; setting the maximum spread to limit the impact of currency volatility and wide spreads on the corporate's average rate.

Developing the complex algorithms to achieve this is a massive undertaking – about the skills and software that would be needed to make them a reality. Then there are issues such as the need for back testing, manual oversight and security. The biggest impediment to rapid take-up may well be the treasurer's primary concern with risk management. Nonetheless, there are still good reasons to keep a watching brief on what algorithms make possible, as this evolves.

Adam Gable, a treasury specialist with the banking software vendor Temenos, has high hopes for the future, which he shares by explaining how a corporate treasury in a global operation could exploit rule-based algorithms to manage liquidity and ensure the best return on surplus. "Unless there is a clear strategy around this and the ability to execute the same swiftly, it is difficult to achieve optimal returns," he says. A manual process can be repetitive, exhausting and create delays that lead to potential loss of good opportunities to invest.

"An algorithm that could assess liquidity across the group, identify surplus, assess market rates for the instruments under consideration and then identify the best asset class and provider, even suggesting currency conversions where appropriate, would certainly have legs," he says.

But there are even more impressive possibilities shimmering on the horizon. He adds: "Introduce machine learning, which, given the time of the month and year, could predict the most optimal trade, and we are in corporate treasury utopia."

Lesley Meall is a freelance journalist specialising in technology and finance

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WINNING PERFORMANCE

PERFORMANCE RATIOS ARE IMPORTANT, BUT OFTEN MIXED UP. DOUG WILLIAMSON OFFERS CLARITY TO HELP YOU AVOID THE RED HERRINGS

Treasurers need to make decisions based on the financial performance of many different organisations, including our own. So we need to understand how to evaluate financial information in a rigorous and consistent way.

It's not just profits

Profits are vital, especially to shareholders and other investors. But how much investment does the business need, to earn the profits? If the capital investment is too great, the profits aren't so attractive.

Return on capital

Treasurers use ratios to compare different businesses. For example, return on capital ratios divide profit by capital, to calculate a percentage rate of return on the capital investment.

Return on capital
Profit
÷ Capital
= Rate of return %

Treasurers need to understand

Return on capital is a fundamentally important performance measure.

Key applications for treasurers are to:

- Appraise business investment proposals;
- Evaluate creditworthiness; and
- Support investor relations.

Different perspectives

Return on capital ratios include:

- Return on equity (ROE); and
- Return on capital employed (ROCE, sometimes pronounced 'rocky').

Practitioners vary both the measure of profit and the measure of capital, depending on which investors they're considering.

ROE

ROE is an essential ratio for shareholders. It looks at the after-tax profits earned for shareholders, using the shareholders' equity capital.

	ROE
Investors	Shareholders
Profit	Profit after tax
Capital	Equity

Better or worse?

Let's see how the treasurer uses ROE to take a shareholder's perspective, to analyse two different companies. Their financial performance includes:

Company	A	B
	$m	$m
Profit after tax	6	7
÷ Equity	40	80
= ROE	**15%**	**8.8%**

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Company B is earning greater profits of $7m, compared with Company A's $6m. But Company B is using twice as much equity capital to earn its profits. Company B is using equity of $80m, compared with Company A's $40m.

As a result, Company B is earning an inferior return of 8.8% for its shareholders, compared with Company A's 15%.

All other things being equal, Company A is the better investment.

Avoid red herrings

Like many financial ratios, the final calculation of ROE is a simple division of one number by another. The trickier bit can be remembering what to divide by what, especially if a question contains red herrings.

Red herrings are non-relevant information, which is potentially distracting. Exams often contain one or two red herrings, to test our practical ability to identify and use the relevant information only.

Company C

Company C has reported: operating profit €12m, profit after tax €7m, equity €70m and non-current liabilities €30m.

Calculate the return on equity.

Based on CertTF 2016 question

Relevant information

The information we need for our ROE calculation is the profit after tax of €7m, and the equity of €70m.

ROE (€m)	
Profit after tax	7
÷ Equity	70
= ROE	**10%**

The other data in this question isn't relevant for the ROE calculation.

However, it would be relevant for ROCE.

ROCE perspective

The important difference between ROE and ROCE is their perspective:

- ROE assumes the viewpoint of the shareholders only; while
- ROCE takes the wider perspective of all capital providers, not just shareholders.

Profit and capital

To reflect this wider perspective, ROCE's profit and capital measures are both different. Keeping it simple at this stage, the profit measure is normally operating profit. Again, keeping it simple for now, the capital definition is normally equity plus non-current liabilities. This wider measure of capital, defined for the ROCE evaluation, is known as capital employed.

	ROCE
Investors	All capital providers
Profit	Operating profit
Capital	Capital employed

ROCE for Company C

We've already calculated Company C's ROE as 10%. Now let's calculate its ROCE. The information we need is:

Operating profit = €12m
Equity = €70m
Non-current liabilities = €30m

Now we need two steps:
(1) Capital employed; then
(2) ROCE.

(1) Capital employed

This is the total of equity and non-current liabilities:

70 + 30
= €100m

(2) ROCE

ROCE (€m)	
Operating profit	12
÷ Capital employed	100
= ROCE	**12%**

Using financial statements

The treasurer often needs to extract important information from financial statements. For example, Company D's financial statements include:

Profit or loss (€m)	
Operating profit	24
Interest and tax	(10)
Profit after tax	14

Financial position (€m)	
Equity	140
Non-current liabilities	60
Capital employed	200

HELP FOR ACT STUDENTS

Download further useful study information from the Resources area of the ACT Learning Academy at learning.treasurers.org or from *The Treasurer's Wiki* at wiki.treasurers.org

Company D

Using the financial statements (above), calculate company D's:
(a) ROE; and (b) ROCE.

Answers below

Refining ROCE assessment

Depending on the context, and available information, the ROCE evaluation is sometimes refined. We might refine either or both of:

(a) The capital measure; and
(b) The relevant profits.

(a) Capital employed: refinements

Two potential adjustments are:

(1) Short-term borrowings, if they are being used as part of longer-term capital, to add to capital employed; and
(2) Cash and cash equivalents, to net off.

It's essential to confirm all definitions in practice, and then apply them consistently.

(b) Profits and tax

Profits for the ROCE evaluation are sometimes after tax. When ROCE is used in value-added analysis, it is always after tax. This is because the tax authorities must always be paid first. Any remaining surplus for the investors will be after tax.

Return on study hours

The same applies to your studies. You can look forward to a handsome return, but only after investing your necessary study hours.

Answer: (a) ROE = 14/140 = 10%; (b) ROCE = 24/200 = 12%

With many thanks to Paul Cowdell for his valued advice.

Doug Williamson is a treasury and finance coach

SEVEN BOOKS FOR SEVEN TREASURERS

Looking for some winter reading? Here are six of our favourites (and one to avoid)

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The 7 Habits of Highly Annoying CFOs

By Steven RJR Covariance

This treasury-centric reworking of the business school classic spells out the warning signs every treasurer should watch out for. A true management classic, it contains legendary observations on what makes a CFO even more annoying than they have to be. For example, there's habit 2: "Begin with the blame in mind." If it's not the CEO's fault, it must be treasury's fault. Or habit 5: "Seek first to pass the buck, then take all the credit."

Who Moved My Cash?

By Dr Prof Smarty Smarts

Inspired by a mind-numbingly simplistic, but nonetheless bestselling, management book, this special edition for treasurers spins out a statement of the blindingly obvious, thinly veiled as a patronisingly childish parable that fills a tree-killing 87 pages. Moral? It's not just about how much cash you have, it's having at least a vague idea how much cash is coming in and how much is going out. Go figure. No, really. Go figure.

Fifty Shades of Grey Area

By PC Plod

Financial regulators are inflicting real pain, sharp pain, bruising pain – and bankers have the scars to prove it. But they've been naughty and must be whipped into line. How far can the rules be bent and twisted without breaking? How much can the bankers writhe in their shackles, struggling to find a loophole that will set them free? And if the regulator decides to punish, will it be a humiliating tongue-lashing? Or leg irons?

David Coppermine

By Whatda Dickens

One of Dickens's most famous characters, Mr Micawber-Dosh, offers fundamental lessons for aspiring corporate treasurers: "Annual income twenty pounds, annual expenditure nineteen pounds, nineteen shillings and sixpence, result: surplus cash and banks queuing up to sell us cash-pooling arrangements. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result: funding gap and banks pretend they don't even know us." A tale of fraud, double-dealings and debtors' prison, it has been said to be the favourite book of a number of corporate wheeler-dealers, who, frankly, should all be in jail by now.

My Tears with General Motors

By Alfred E Neuman

Heart-warming story about how, as the financial crisis started to bite, a plucky band of Detroit car manufacturers flew in their private jets to Washington to ask for a financial bail-out. Then they flew back to Detroit in their private jets, empty-handed. Then they got the Greyhound bus back to Washington and tried again.

The Rates of Wrath

By John Stonebank

Tragic story of cash-rich corporate treasurers scouring the depression-hit dustbowl in search of yield. As they fight over the merest scraps, some are even prepared to accept negative yield and a free bank-branded 'stress ball' toy in return for a safe haven for their precious cash. It doesn't end well.

The ACT Treasurer's Handbook

The absolutely definitive guide to absolutely everything in corporate treasury. Told with wit, passion, plot twists, love, romance, adventure, thrills, chills and no small measure of horror, this epic poetic tale takes you on a thought-provoking journey of enchantment, jealousy and slapstick comedy that sweeps from 13th-century Polynesian traders to the smoke-filled corridors of modern-day cash management. A riveting page-turner. *Spoiler-alert*: none of this is true, apart from the first 10 words.

Andrew Sawers is a freelance business and financial journalist. He is a former editor of *Financial Director* and has worked on *Accountancy Age*, *Business Age* and *Commercial Lawyer*. He tweets as @Mr_Numbers

MICHAEL PAGE TREASURY

2016/2017 Events

Over the past 12 months we are proud to have hosted a range of successful events and social evenings, focussing on some high profile topics seen in the market this year. These include:

- **Making the move from Group Treasurer to CFO**
- **Debt Capital Markets**
- **Women in Treasury**

Next up for us is an evening for those currently in a number two position looking to ready themselves for a first step into a Group Treasurer/Treasurer role, due to be held in early 2017.

If this is something you would be interested in hearing more about, if you have any other questions about the current market or simply some impartial advice about making a potential move please reach out to one of the team:

- **Kyra Cordrey - Operating Director**
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