DEALS OF THE YEAR 2016
How to enter this year's awards and secure your place in the limelight

LOCATION LOCATION
The case for having treasury operations in Hong Kong

THE GLOBAL TAX PROJECT
International measures that aim to level the playing field

The Treasurer

THE MAGAZINE OF THE ASSOCIATION OF CORPORATE TREASURERS

OCTOBER 2016

14-PAGE SPECIAL

Cash & liquidity management

Europe's conversion cycle, payment and settlement trends, and cash mountains

PLUS

SKILLS RECOGNISED
Microsoft's Rahul Daswani on structured finance and the need for good communication

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

ACT
LEADING TREASURY PROFESSIONALS

Editor's letter

Throughout the year, the ACT puts unflagging effort into backing treasurers at every level – by ensuring that younger members and students are well supported through their studies and throughout the examination process, by setting up networking and mentoring opportunities, and by encouraging all its members to applaud and promote the achievements and initiatives of their fellow treasurers.

This month, there is an opportunity to join that effort by entering or nominating your organisation for *The Treasurer*'s Deals of the Year Awards – a chance to flag up the transactions and initiatives that really put your organisation ahead of the pack. For more details on how to enter, turn to page 9.

Elsewhere, tax has been exercising us this month. In July, G20 finance ministers endorsed a 15-point action plan from the Organisation of Economic Co-operation and Development (OECD) with the laudable aim of limiting aggressive tax planning on the part of multinationals and levelling the playing field across businesses.

The project – base erosion and profit shifting (BEPS) – has been many years in the making. However, while the OECD has worked to create a way for governments to sign up to the initiative without surrendering their business-friendly credentials, BEPS is not without its implementation issues and headaches for treasurers. Business journalist Michelle Perry explores the issue in our lead feature on page 22.

This month, we get to look over the shoulder of Microsoft's structured finance guru in Dubai. Rahul Daswani, group treasury manager, plays a pivotal role in securing sales by evaluating the credit risk and liquidity needs of the tech giant's customers and channel partners for the region. It's a standout example of how treasurers can support their organisations by being closely focused on solutions. Business journalist Ben Poole's profile of Daswani begins on page 18.

Our issue this month has a special focus on cash management. Rebecca Brace gives an overview of innovations in payments on page 28 and, in addition, we look at the cash conversion cycle across Europe, trends in payments and settlements across the globe, and cash mountains – why they exist and whether corporates are likely to do away with them any time soon.

If you have a responsibility for a team, you should turn to page 54, where the ACT's director of professional standards and learning, Vanessa Harwood-Whitcher, gives an indispensable guide to how they stand together, and why and when they fall.

Enjoy the issue.

Liz Loxton

editor@treasurers.org
Follow us on Twitter @thetreasurermag

THIS MONTH'S CONTRIBUTORS

Andrew Bale is associate principal at REL with 20 years' experience of working with clients who are delivering complex business change. His focus is on working capital and his feature on Europe's cash conversion cycle can be found on page 32

Carol Ann Northcott is chief risk officer at Payments Canada and is responsible for its risk management programme. She has a special interest in systemically important systems and writes about trends in national settlement systems on page 36

James Stretton is a director at financial risk advisory firm JCRA, with nearly 30 years' experience in FX risk management. His article on why we can no longer assume once-reliable currency pairs are a safe bet for the future is on page 46

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Members of the Events and Publishing Forum (EPF) provide the ACT with strategic and consultative support **a)** developing relevant issues with a medium-term horizon; **b)** apprising the ACT team of competitor developments; **c)** broadening the speaker and contributor network; and **d)** underpinning the ACT's overall aims (in education, membership growth, international development). If you are interested in participating in the EPF, please contact jtewungwa@treasurers.org

EUROPEAN ASSOCIATION OF CORPORATE TREASURERS
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Treasury that Moves You.

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CASH & LIQUIDITY MANAGEMENT

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

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18 "The development of financial markets in the Middle East has frankly been quite slow"

Rahul Daswani, group treasury manager at Microsoft

Agenda

For the latest news and comment in the treasury world, follow us on Twitter **@thetreasurermag**

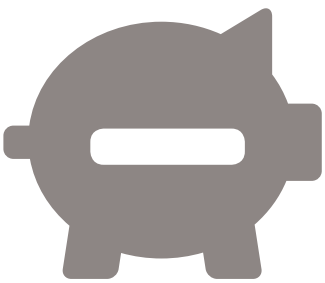
{ CORPORATE FINANCIAL MANAGEMENT }

EUROPEAN CORPORATES TAKE BOND YIELDS INTO NEGATIVE TURF

Henkel, a German consumer goods group, and French pharmaceutical business Sanofi became the first private corporates to sell bonds with negative yields, last month.

The milestone issues are a further indication of how central bank measures to reduce borrowing costs for governments and companies are upending market practices.

Henkel successfully issued a €500m two-year bond with an initial yield of -0.05% and a couple of 0%. It is one of four tranches across three currencies, with the other three tranches at 0% or positive yields.



Henkel also issued a €700m five-year bond with a coupon and yield of 0% pa; a $750m three-year bond with a coupon of 1.5% pa and a £300m six-year bond with a coupon of 0.875%. The initial yields for the dollar and sterling bonds are 1.55% and 0.95% respectively.

The acquisition of Sun Products is valued at €3.2bn and will be financed by a three-year bank loan of €1bn in addition to the proceeds of the bonds.

Sanofi sold €1bn of three-and-a-half-year debt, also at a yield of -0.05%.

With yields in negative territory, backers are paying to invest, but if bond yields fall even more, bond price rises and investors can sell the bond at a profit. Central banks are notable buyers, with the European Central Bank expanding its quantitative easing programme to include corporate bond purchases in June this year.

The ACT's associate policy and technical director, Steve Baseby, said corporates may find negative yield debt attractive for new investment or refinancing, but their business returns will also be under pressure, so they will need to consider whether they are ahead in the round.

"More immediate concerns are that any surplus cash generated by the bonds may earn an even more negative yield. What is unknown is whether these bonds are attractive as an alternative to government debt, and cause debt investors to diversify into corporate debt," he said.

WORDS

"A splash of claret, a flick of cigar ash, the nip of a bulldog and even a spin in the washing machine."

Bank of England Governor Mark Carney (pictured, above) describes the mishaps that the newly introduced polymer £5 note is capable of withstanding.

SOURCE: *FINANCIAL TIMES*, 13 SEPTEMBER 2016

{ CONTEXT OF TREASURY }

Brexit delay muddies economic and political indicators

The political turning point represented by the UK vote to leave the EU continues to confound politicians and economists alike, with contradictory signs on both fronts.

Retail sales and consumer confidence have rebounded and the economy has been assisted by a weaker pound and the Bank of England rate cut, say commentators. However, business confidence has fallen in Europe, and inflation in the UK and on the continent is low.

At the time of writing, secretary of state for Exiting the European Union David Davis (pictured, right) has not given details on the direction Brexit negotiations would take or when they would begin. However, he has indicated that the UK will try to negotiate a bespoke relationship with the EU versus a solution such as membership of either the European Free Trade Association or the European Economic Area. The government has indicated that it is unlikely to trigger Article 50, which starts negotiations to leave the EU, until next year.

The apparent postponement has drawn fire from Europe. Erik Schweitzer, head of the German chamber of commerce and industry, criticised prime minister Theresa May's decision to postpone Brexit talks until next year, telling the *Financial Times*: "The deadlock is creating a situation in which many investments are now held up and will not be carried out because people don't know what the conditions will be over three or four years."

SHUTTERSTOCK

Meanwhile, Donald Tusk, president of the European Council, has said that starting the negotiations as soon as possible is in everyone's interests.

{ KEY FINDINGS FROM THE CAPGEMINI *WORLD WEALTH REPORT 2016* }

4.2m
Europe's high-net-worth individuals (HNWI) population in 2015, up 4.8% on the previous year

4% the overall growth rate of HNWI wealth worldwide

60%
the proportion growth in the HNWI population accounted for in China and Japan alone

$100trn
the expected combined worth of the world's wealthiest individuals (those worth over $1m) by 2025

Two fifths
the amount Asia-Pacific's projected share of HNWI wealth will represent over the next decade if past growth rates continue

{ TREASURY OPERATIONS }

Fintech trade groups to form global federation

UK-based fintech trade group Innovate Finance, a UK trade group for fintech organisations, has launched an international collective of start-up hubs in the sector, with the aim of nurturing new firms and helping each other get new ideas to market.

The Global Fintech Hubs Federation (GFHF) will cover more than 20 countries, including Canada, China, Germany, Mexico, Switzerland and the UK, and has been formed in partnership with Innotribe – the financial services innovation wing of worldwide payments network SWIFT.

As well as its ambition to support global engagement on fintech matters and industry best practices, the GFHF will also develop a global set of knowledge standards in the field and build bridges between member hubs. It will provide fintech hubs with a global voice in the business and finance community.

While Innovate Finance and Innotribe have stressed that the GFHF will be a cooperative rather than competitive organisation, it will nonetheless rank its member hubs according to several criteria – such as ease of doing business, talent and capital availability.

Innovate Finance CEO Lawrence Wintermeyer said: "Coordination and cross-border dialogue between emerging fintech start-ups, established fintech companies, financial institutions and policymakers remains key for the long-term success of our sector.

"The launch of the GFHF will provide a platform for global fintech players and hubs to share knowledge and build an inclusive community network. This will help to accelerate the growth and influence of global fintech, and shape a better financial services future."

SWIFT and Innotribe global head of securities markets Fabian Vandenreydt said: "Innotribe looks forward to foster a bigger and stronger fintech ecosystem through this initiative, bringing its expertise and leveraging its network for the benefit of the banking and start-up communities."

What do you say?
Tweet us @ **thetreasurermag**

REX FEATURES

"EU member states have a sovereign right to determine their own tax laws. State aid cannot be used to rewrite those rules. However, the current state aid investigations into tax rulings appear to do exactly that."

Former EU competition commissioner Neelie Kroes (pictured above) dismisses the Commission's ruling that Apple owes the Irish government €13bn as unfair.

SOURCE: *THE IRISH TIMES*, 1 SEPTEMBER 2016

{ CONTEXT OF TREASURY }

EBRD to publish data on NPLs

Details of non-performing loans (NPLs) in emerging Europe are to be detailed in a new online resource from the European Bank for Reconstruction and Development (EBRD).

The bank has launched the website with the aim of gathering as much policy and finance industry research as possible around poorly performing loans in the Central, Eastern and Southeastern region, which, it says, has some of the highest and most persistent levels of Europe's €1.1 trillion in NPL stocks.

The EBRD says sharing information about NPLs will help strengthen the banking system within Europe's emerging countries.

The bank says it hopes the resource will aid transparency and the development of frameworks that will promote efficient restructuring.

$14bn – the value of cargo left temporarily stranded at sea due to the financial woes of Hanjin Shipping of South Korea and uncertainty as to who would pay docking, storage and unloading fees

$17.71bn – the amount US consumer credit balance rose by in July compared with June, reflecting stronger-than-expected consumer spending and demand

20% – the increase in UK employees working zero-hour contracts, according to the UK Office for National Statistics, taking the number to over 3% of the workforce

£1.49trn – the amount Brits collectively owed in personal borrowing at the end of July, according to the Money Charity, up from £1.44 trillion the previous year

50% – increase in house viewings in London's wealthiest areas, according to the *Financial Times*, as overseas buyers take advantage of a weak pound

9.1% – the year-on-year drop in new car sales in the US, as reported by VW, suggesting a boom in US car sales is coming to an end

{ TREASURY OPERATIONS }

South Africa's strong growth in renminbi use

Data tracking renminbi use globally shows the currency gaining significant ground in South Africa. Data from SWIFT show renminbi use in payments sent from and received by South Africa increased by 65% over the past 12 months and by 112% over the past two years.

The increase marks strengthening trade ties between South Africa with China and Hong Kong. "The establishment of a renminbi clearing centre in South Africa, as well as Singapore's increased use of the renminbi for payments with South Africa, have been a catalyst for renminbi growth in the region," says Harry Newman, head of banking at SWIFT.

The data also show how one country's increasing use of the renminbi can benefit existing financial centres for the currency.

"While South African institutions have been stepping up renminbi payments with counterparties beyond Hong Kong and China – and Singapore has been a notable beneficiary of this – the growth in overall volumes of payments from South Africa this year means that payments exchanged with Hong Kong and China are much higher than they were at the end of 2015," says Vina Cheung, global head of renminbi internationalisation, global liquidity and cash management, HSBC.

"South Africa is still in the early stages of renminbi adoption, but we believe there is considerable potential for growth in payments exchanged with this key African economy and other emerging markets."

{ KEY FINDINGS FROM THE 2016 CORPORATE TREASURERS SURVEY CONDUCTED BY TEMENOS AND OVUM }

THE STATS

31% said liquidity management was by far the greatest priority for the next 18 months

17% said FX risk focus was their number one concern

16% said accurate forecasting was their top priority

14% said a complete view of cash positions was top

35% of all corporates – and 42% of those with revenues of more than $10bn – said lack of real-time data was a significant operational issue

{ AROUND THE WORLD IN 30 DAYS }

BoE SETTLEMENTS, AIRLINES, INVESTMENT BANKS

BoE settlements to be 'blockchain ready'

Non-bank payment providers will be able to access a new payments settlement system, according to proposals published by the UK's central bank.

The Bank of England (BoE) has released information about a replacement for its 20-year-old Real-Time Gross Settlement system, which daily handles around £500bn of payments between banks.

The new system will be compatible with distributed ledger technology and capable of operation 24 hours a day, seven days a week. The current system operates 12 hours per working day.

The BoE will conduct a public consultation closing in December and publish a final plan early next year.

Volatility hits Asian airlines

FX volatility has damaged performance at China's biggest state-run airlines, according to figures released by the Shanghai Stock Exchange.

Asian airlines suffer as a result of FX volatility

Profits at China Southern Airlines were down 10.4% for the first half of 2016, while profits at China Eastern Airlines fell 9.3%. At Air China, profits fell 17.5%.

A 6% devaluation of the yuan between August last year and the end of June this year was cited as the cause.

Southern's chairman, Wang Changshun, said that his carrier had worked hard to mitigate its problems through "advanced repayment of US-dollar liabilities" and a swap of its dollar obligations under finance leases, reducing its commitments around the US currency.

In tandem with that, he added: "The financing proportion of renminbi increased to 50.8% from 31.7% at the beginning of the year – therefore, the impact of the exchange loss decreased."

Income fall at investment banks

In the biggest fall in revenues since the global financial crisis, the world's biggest investment banks took a 15% hit on their combined income.

A lack of deals, together with falls across stocks, bonds and commodities, were behind the fall, particularly in the first quarter of 2016, according to a report from London-based research outfit Coalition.

Income from trading stocks and bonds, advising on M&A and capital raising, was $79bn for the half year, down from $93.3bn in the first half of 2015.

Coalition says the banks expect the picture to improve over the second half of 2016. However, regulation around capital and risk-taking are likely to keep a lid on growth.

Celebrating 20 years of treasurers' deals

This year marks two decades of the outstanding achievements of corporate treasurers and their teams

Nominations will soon be under way for *The Treasurer*'s Deals of the Year Awards 2016. And what better way to showcase your achievements among the most talented and innovative treasury and finance professionals than by making the cut in its 20th year?

The first deals officially recognised, in 1997, were those of UK companies deemed noteworthy – in other words to have 'caught the eye' of *The Treasurer*. And all against a backdrop of the Asia financial crisis, Hong Kong's return to Chinese rule, a second term for Bill Clinton and, in the UK, Tony Blair becoming prime minister, the Financial Services Authority coming into being and the Bank of England being given independence by Chancellor Gordon Brown to set interest rates. Among the winners were ICI's acquisition financing to buy Unilever's speciality chemical business, Stakis's foray into the private placement market, Castle Transmission International's bond offering to refinance debt, and The Daily Mail and General Trust's exchangeable bonds.

Since this comparatively understated start, *The Treasurer*'s Deals of the Year Awards have grown and evolved from an inaugural awards lunch in 2003 at Cazenove, where a shortlist of winners in six categories were voted for by ACT members and *Treasurer* readers, to the first dinner event held at Drapers' Hall to mark the 10th anniversary. The 2007 awards also saw the launch of a new category – Treasury Team of the Year. This become two awards – split into large and mid-cap team categories the following year – and in 2012, the ACT included an award for the European Treasury Team of the Year. But what hasn't changed is the recognition of excellence and celebration of the far-ranging successes across all aspects of treasury – the standout and applause-worthy achievements from the treasurer's point of view, judged on the merits of the deal as a treasurer would see it.

Over the past 20 years, deals nominated have totalled over $2 trillion and we've had more than 2,500 nominations. The league table of repeat winners is impressive – Arqiva, Barratt Developments, British American Tobacco, Essar Energy, ICI, Merck, Rolls-Royce, SABMiller, Sky, Tesco, The Co Op, Vodafone – and is topped by National Grid, with six wins over the years. (It also includes the now de-listed Cadbury Schweppes and Invensys, subsequently taken over by Mondelez International and Schneider Electric respectively). Last year's European Treasury Team of the Year winner with Rando Bruns (profiled in next month's issue) at the helm was Merck, taking it to equal second place overall along with Vodafone and the then Cadbury Schweppes.

The distinguished Deals of the Year Awards panel comprises experts and practitioners from across the spectrum of corporate finance and funding. The roll call of chair of the panel of judges over the years has included: Joanna Parker FCT, Matthew Hurn FCT, Jono Slade FCT and Lesley Flowerdew FCT. This year, we are delighted to welcome a new chair – Philip Learoyd AMCT, head of funding and treasury risk at SABMiller. Our thanks also go to Lloyds Bank, which began its long-standing support of the awards back in 2005.

The deadline for nominations is 18 November and winners will be announced at the Deals of the Year Awards Dinner in February next year. We encourage all treasurers, as well as your banks and advisers – go on, give them a nudge – to nominate as many deals as you wish. You can see the full list of categories, along with details of how to nominate, at www.treasurers.org/awards/2016

So, come on, what are you waiting for?

{ AWARDS CATEGORIES }

Overall Deals of the Year winner

Bonds with a currency value above £500m or equivalent

Bonds with a currency value below £500m or equivalent

Corporate finance

Loans above £750m

Loans below £750m

UK Treasury Team of the Year (market cap above £2bn)

UK Medium-sized Business Treasury Team of the Year (market cap below £2bn)

European Treasury Team of the Year

THIS MONTH

UK QE AND REGTECH

In the UK, the latest round of quantitative easing has affected yields and we write below on the double-edged sword of cheap debt and low pension discount rates. Elsewhere, we are monitoring the development of the Brexit plan and continue our conversations with regulators and key decision-makers to ensure that the voice of the corporate is heard. Further afield, EU money market fund (MMF) legislation evolves, while the new US MMF rules come into being this month – make sure your policies remain effective.

If you have views you'd like to share with the ACT policy and technical team on any of these subjects 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 }

UK QE: investment stimulus, cheaper corporate financing or pension deficit booster?

The Bank of England (BoE) has started its next phase of quantitative easing (QE): the attempt to stimulate investment by lowering long-term lending costs by competing in the markets to buy UK government and corporate debt.

This follows the lowering of the base rate to 0.25%, to lower further short-term investment yields and encourage cash holders, individuals and businesses to risk their deflating cash asset on other assets.

The problem the UK shares with other Western economies is that the acceptable stimuli have become few. The BoE has base rates and QE, a target consumer price inflation of 2% (currently 0.6%), coupled with a commitment to a stable financial system. The government of the moment can tinker with tax rates and/or overspend (that is, borrow). Simple and crude weapons in the battle for growth.

However, investment decisions are not simple or uniform in their nature. Business needs to consider the reliability and cost of supplies, and the likelihood of customers at the right price, while satisfying a host of planning, environmental, labour and tax laws.

IKON IMAGES

Then there is the cost of financial capital to consider – of which the cost of debt is a part. The base erosion and profit shifting initiative may affect the cost of capital as the benefit of lower interest rates is eroded by caps on interest deductibility.

Economic uncertainty

And then there are the levels of uncertainty in the economy: the Brexit process is hardly started. Financial institutions may need to digest the loss of EU passporting and the risk that they do not have financial regulation equivalence in its place (see passporting and equivalence primer, opposite). Non-financial businesses, which comprise the bulk of our members' employers, also have uncertainty over equivalence; the future form of environment and labour laws and practices, and, more critically, continued access to overseas supplies and customers on terms that enable their UK-based businesses to thrive.

One flaw in the QE argument is that too much simultaneous change becomes difficult to digest. The variables in the business plan become too many. The best-case and worst-case scenarios move further apart. Where you may end up in the gap between becomes less certain. A lower cost of debt only assists to ameliorate the broader uncertainty, and the borrower may wish to do no more than use borrowed funds to distribute to shareholders, many of which are not UK domiciled, thereby passing on the investment decision beyond the UK.

Another flaw of QE is that the buyers of UK debt remain substantially the long-term funds, including the defined benefit (DB) pension funds of many borrowers. Beyond a requirement to invest part of their funds in low-yielding gilts, these DB funds' mismatch of assets and liabilities is worsened by the use of long-dated gilt yields (whose rates are lowered by QE) as the discount factor to value the fund.

The UK has so long a history of DB pension funds that even those that closed theirs years ago still have DB funds, because we have become very good at staying alive, and so the assets accumulated in the past cannot meet the forecast liabilities of today.

Tata Steel and BHS may, in time, become known as the beginning of the end of DB funds – the point at which we began to consider whether we want to be comfy pensioners or be an economy with tax-paying businesses and employees to fund all that social infrastructure that helps us to live so long.

In the meantime, we will continue to argue that QE may aid financial market stability, but it cannot be relied on to stimulate the commercial sector, which must reconcile uncertain times for its business with an increasing social welfare liability. Broader-based stimuli, which are focused on areas of need, are required, and for this we must look to the chancellor and not the BoE governor, whose remit is too limited.

NEW ON THE WEB

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

- **Brexit 2016 – a post-referendum checklist for treasurers**
- **Brexit Q&As – painting by numbers**
- **ACT responds to UK BEPS consultation**

The policy and technical team has written various blogs this month at https://blogs.treasurers.org

- **Responding to the UK's payments strategy consultation**
- **Brexit myopia leads to non-Brexit solutions?**
- **ACT: the corporate voice in developing UK Markets Standards**
- **QE: investment stimulus, cheaper corporate financing or pension deficit booster?**

{ INTERNATIONAL/BREXIT }

PASSPORTING AND EQUIVALENCE – A PRIMER

The UK has the largest financial services industry in the EU and, post-referendum, the small matter of how this industry will continue to operate looms large.

Passporting, which is how the industry operates at present, is a European Economic Area (EEA) right and, subject to meeting any conditions under a relevant single market directive (for example, Solvency II), a firm authorised in an EEA state is entitled to carry on permitted activities in any other EEA state by either exercising the right of establishment (of a branch and/or agents) or providing cross-border services.

For the UK, one post-Brexit model mooted is the 'Norway' model; a member of the European Free Trade Association and so in the EEA, Norway has passporting rights in exchange for free movement of people. This may not be acceptable to the UK for political reasons (free movement of people being the major issue for the UK electorate), and so an alternate solution would be required – perhaps equivalence.

Equivalence rests on ensuring that similar regulatory outcomes, such as reducing systemic risk in the financial markets, are achieved irrespective of regulatory framework. This is the way that countries such as the US currently 'trade' within the EU.

As current UK regulation is based on EU rules, establishing equivalence should be relatively straightforward, and the UK would 'just' need to demonstrate that future changes in regulation do not impact the outcome from a systemic risk perspective.

{ WATCH THIS SPACE }

Regtech – the new fintech?

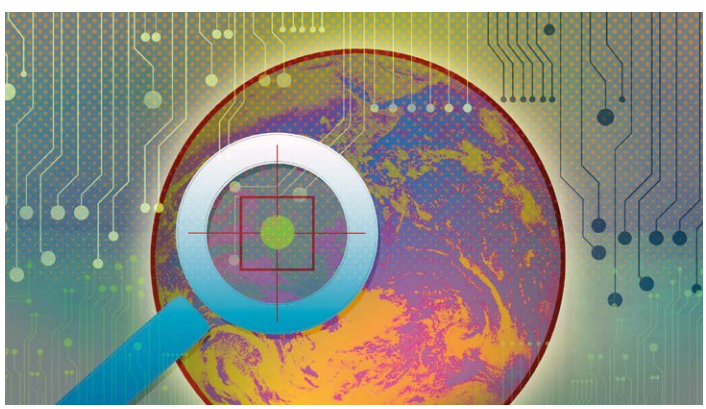
Even while some of us are still getting our heads around fintech and what it means in practical terms for our organisation, there is a new kid on the block: regtech (regulatory technology – the use of technology to deliver solutions to regulatory requirements). And, this time, the practical application may be more apparent to treasurers.

Firms want to comply with ever-expanding, but frequently inconsistent, regulatory requirements; regulators want to make use of the information provided – at present, neither of these things are happening efficiently.

Furthermore, as all the theories tell us, data needs to be accurate, secure, timely and standardised, and reporting needs to be cost-effective, flexible and timely to comply with whatever the regulators require. This is where regtech comes in.

Regtech solutions are being designed to provide consistent interpretation of the rules, compliance and the automation of reporting by taking standardised data from legacy systems and having the flexibility to manipulate it into the reporting formats that the various regulators require. The magic of regtech (in theory) is that one set of data can be cut in many different ways to provide the information required by different regulators and, as a result, it helps firms automate compliance tasks and reduce operational risks associated with compliance and reporting obligations.

Ultimately, it might even provide a solution for the agony for most corporates that is KYC...



IKON IMAGES

{ TECHNICAL ROUND-UP }

The US money market fund (MMF) reforms come into effect on 15 October. The Securities and Exchange Commission Rule 2a-7 defines the quality, maturity and diversity of investments allowed in MMFs. A significant Rule 2a-7 change is the introduction of variable (or floating) net asset value funds for prime, ie non-government, MMFs. The US Association of Financial Professionals' 2016 liquidity survey found that 62% of corporates plan to make changes in how they invest in prime funds as a result of these reforms. European MMF regulatory changes are still a work in progress, with trialogue negotiations taking place and a possibility of seeing the final text before the end of 2016.

The Global Financial Markets Association has issued a report, commissioned from Oliver Wyman, called *Interaction, Coherence, and Overall Calibration of Post Crisis Basel Reforms*. The report provides a comprehensive analysis of the potential costs of the new Basel standards on lending and capital markets. Overall, it estimates that the median increase in funding cost for loans is 60-84% bps. A copy of the report can be found at www.oliverwyman.com/content/dam/oliver-wyman/global/en/2016/aug/post-crisis-basel-reforms.pdf

Poland has become the first European country to issue a panda bond. In late August, the Polish government issued a three-year ¥3bn bond with a yield of 3.4%. Panda bonds, yuan-denominated onshore bonds issued by foreign entities, were first permitted in 2005 and, historically, issuers have been international financial institutions. Key developments in the panda bond market were outlined in *The Treasurer* (July/August 2016, page 32).

JAMES RUDOLPH
DEPUTY TREASURER, CENTRICA PLC

How did you get into treasury?
Working in finance roles at Centrica, I was responsible for negotiating the project financing of our operating offshore wind portfolio. From there, it was a small step into the treasury team.

What do you like about treasury?
I love working with bright and enthusiastic people on problems that have a real value impact on the company. It is a great combination of analytical problem-solving and team working.

What's the best thing about being a treasurer?
Feeling that I make a difference.

What's the best thing about being a member of the ACT?
It's the confidence that comes with being a member of a respected professional organisation that seeks to lead the development of the treasury function.

Which ACT qualifications do you hold?
I have just got my AMCT and I'm taking a breather while thinking about the MCT.

How has your qualification benefited you in your career so far?
It is a great way of getting the theoretical knowledge to underpin practical experience. It provides you with confidence to work your way through problems efficiently and effectively.

What would be your best piece of advice to someone else considering a career in treasury?
Make sure that you get a range of experiences in your early career so that you can build on strong foundations.

What's your ultimate career goal?
To feel that I have used my skills in the best way I can to add value and make a difference for myself and the company I work for.

If you weren't a corporate treasurer, what would you be and why?
We got our first dog recently, who is a hyperactive bundle of joy, so perhaps a dog walker – more exercise and lots of affection.

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

12 October, London
Foreign exchange
Learn about the different types of FX risk and develop an ability to advise both commercial operations and senior management about FX risks and on the responses available to meet those risks.

13 October, London
Interest rate risk
Gain a deeper understanding of the many aspects of interest rate risk, how it affects different firms and its inevitability. This course will teach you the concepts for evaluating the different aspects of interest rate risk with hands-on modelling experience.

18 October, London
The nuts and bolts of cash management
Learn more about cash and liquidity management, and its importance to the business and to the treasury function. The programme examines the basic building blocks of cash management from the domestic perspective and, through a series of case studies, extends these basic principles to tackling the complexities of international cash management.

19-20 October, London
Advanced cash management
This two-day course will arm you with the knowledge to prepare for a rapidly changing environment, where global banks are 'deglobalising' and corporates will increasingly be multibanked. New techniques are being introduced, and the regulators are enabling new types of competition to traditional banks.

1-2 November, London
Treasury security, control and audit
Develop an all-round understanding of how to create a secure environment in which treasury transactions can be managed and carried out with minimum risk of fraud or error, and be able to judge the adequacy of any arrangements and make or recommend necessary changes.

8 November, London
Treasury in a day
An introduction aimed at anyone new to treasury, looking to broaden their understanding of the function or improve their ability to have better conversations with management, operations, banks or treasurers as customers.

14-18 November, London
A-Z of corporate treasury
An intensive five-day overview of treasury management, perfect for new entrants to the profession, bankers and those working alongside treasury.

To view more courses or to book online, visit www.treasurers.org/training. For more information, contact Radmila Trkulja at rtrkulja@treasurers.org or call +44 (0)20 7847 2573

ACT EVENTS

24-25 October, Dubai
ACT Middle East Annual Summit
Now in its seventh year, the ACT Middle East Annual Summit is the largest and most popular treasury event in the Gulf Cooperation Council, uniting the region's leading corporates.
www.treasurers.org/middleeastannualsummit

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
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.
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.
www.treasurers.org/cashmanagement

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{ CORPORATE TAX }

JEREMY WARNER

The European Commission's competition commissioner says Apple's arrangements with Ireland amount to state aid, putting the EU at odds with international agreement

Few things would prompt Tim Cook, the normally unflappable chief executive of Apple, to lose his temper and publicly describe something as "political c**p", but the European Commission has, somewhat unsurprisingly, managed it with its €13bn tax ruling against the American tech giant.

Before wading into the specifics of the Apple tax row, it's important to set the debate in its proper context. Everyone knows of the distinction between tax evasion and tax avoidance, the one being illegal and the other... well, some companies used to argue that it was a fiduciary duty to pay as little tax as possible by whatever legal means were available.

Many companies did it, and perhaps oddly, until quite recently, there wasn't much of a public outcry against it. To the contrary, lots of governments regarded tolerance of avoidance as a form of tax competition, a way of attracting multinationals to their particular tax jurisdiction.

The public mood has changed. Particularly since the financial crisis, voters have demanded that companies pay their fair share. Nothing Apple did was illegal, and what's more, it was positively encouraged to act in the way it did by the Irish government. Complicating matters further is the fact that no government has yet got its head around how to tax digital income. In the virtual world, where precisely the profit is being generated is frequently a matter of interpretation.

SHUTTERSTOCK

In any case, Europe's competition commissioner, Margrethe Vestager, has declared that sweetheart deals of the type Ireland struck with Apple are a form of illegal state aid. Notionally, at least, the EU is still meant to be a collection of fiscally independent nations, but there is no denying the force of her argument. If you aspire to a single market, a harmonised corporate tax system is the next logical step.

Even so, what she's done is a clear case of over-reach. As things stand, there is no agreement within Europe to harmonise taxes, and there is highly unlikely to be one in any foreseeable future. The 'double Irish with a Dutch Sandwich' and other tax-avoidance schemes with no legitimate business purpose are being phased out systematically by the G20, and by new rules from the Organisation for Economic Co-operation and Development, which seem to command a high degree of international consensus. The global machinery for 'profit shifting' will face a new regime by 2018.

> Some companies used to argue that it was a fiduciary duty to pay as little tax as possible

In any case, until the world's largest economy, the US, reforms its own corporate tax system, none of this is going to get properly addressed. The US both imposes one of the highest rates of corporation tax in the world, and is extraordinarily aggressive in attempting to tax the overseas profits of its multinationals. Many US corporations, Apple included, thereby have a positive incentive to generate and keep profits offshore, and will naturally gravitate to the lowest tax jurisdictions in so doing. In Apple's case, and that of many others, the situation has become positively absurd, with the company borrowing heavily in the US to finance dividends, buybacks and investment alongside an offshore cash mountain, which had swelled to more than $200bn at the last count.

One of the few decent policies so far announced by Donald Trump in his presidential bid is to slash the corporate tax rate to 15% and give additional tax breaks for repatriated profits. This would neatly solve the Apple 'problem', but it would also be a double blow to the EU, which might find itself losing inward investment and, indeed, overall tax revenue accordingly.

Vestager's ruling has brought the prospect of serious US tax reform that much closer. It's all very well trying to make Europe's internal market into a model of level playing field fairness, but there is always going to be someone attempting to use tax policy to attract business. Who knows? Post-Brexit, it might even be Britain.

See page 22 for more on international developments in corporate tax

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

Central bankers should not fly helicopters

Helicopter money was never intended to be taken as a credible policy move. So it's worrying that the idea is gaining ground

Helicopter money will never fly. Excuse the pun. You might have heard some commentators talking about it, but what is it? Helicopter money was first introduced as a thought experiment by monetary economist and Nobel laureate Milton Friedman in 1969 to illustrate the potential inflationary impacts of monetary policy. Though Friedman never intended the idea as a serious policy proposal, worryingly, helicopter money has become vogue in some circles as the panacea to deliver developed world economies from their growth fatigue and *lowflation*. But as Friedman pointed out, "there is no such thing as a free lunch".

The principle of helicopter money is straightforward. The central bank creates new money, and rather than buying assets in order to introduce the cash into the economy, as it normally would, the central bank transfers the money to economic agents without exchanging any assets, as if throwing the money from a helicopter.

Proponents of helicopter money say the easiest way to pull it off would be to finance a one-time tax cut or increase government spending. The government would act like a middle man, facilitating the transfer of cash from the central bank to the private sector. Unlike normal fiscal expansions, the government need not issue any bonds with a helicopter drop. Public deficits and debt would remain unchanged.

Private businesses and households would invest and spend the windfall, stimulating aggregate demand, generating growth and a rise in inflation. In essence, the 'drop' facilitates a fiscal expansion that would never have to be paid back. Sounds like a free lunch? It isn't.

There are several important reasons why helicopter money is a very bad idea. First, it would, in effect, re-politicise central banks that had gained independence and credibility during recent decades – the independence that helps prevent governments from tinkering with monetary policy for political purposes. Crossing the line between monetary policy and fiscal policy seriously risks undermining the hard-won credibility of central banks. Second, monetisation of fiscal spending would be hard to reverse. Government debt is the primary asset central banks buy and sell in order to conduct normal operations. Without the corresponding assets on the balance sheet, the central bank might find itself short of assets to sell to the market in order to mop up any excess money in the economy in the future.

IKON IMAGES

Helicopter money would seriously risk creating excess inflation

Third, helicopter money would seriously risk creating excess inflation. Arbitrarily increasing demand without increasing supply is a recipe for higher prices. History paints a clear picture. Excessive inflation is far more likely than excessive deflation. Given a choice between either today's world of high employment, slow-ish growth and low inflation, or a 1970s world of rapid inflation and high unemployment, the former is surely better.

More importantly, extreme policies should only be considered when other policy measures are not available or possible. First and foremost, across the developed world, monetary policy is already ultra easy. Thanks to the relaxed policies of central banks in the US, the eurozone, Japan and the UK, the rule of the day in markets is 'no news is good news'. Markets are awash with central bank liquidity and could easily lend more to the real economy without much hindrance if economic participants demanded loans.

Most developed world economies are growing at trend. For non-monetary reasons, potential growth has slowed over the past decade. In the developed world, ageing populations, gross imbalances within and between economies, and a lack of serious supply-side reform are preventing a stronger expansion. Growth is less vigorous than before, and in conjunction with a weaker appetite for debt after the Lehman lesson, inflationary pressures have weakened.

Monetary policy cannot, no matter how drastic the effort, increase the size of the engine that drives an economy. Only other non-monetary policy measures can do that. Central banks have powerful tools at their disposal. Used properly, they can help economies recover smoothly. Used improperly, as history reminds us, they can devastate economies. Helicopter money would be a dangerous step towards the latter.

Kallum Pickering is senior UK economist at Berenberg Bank

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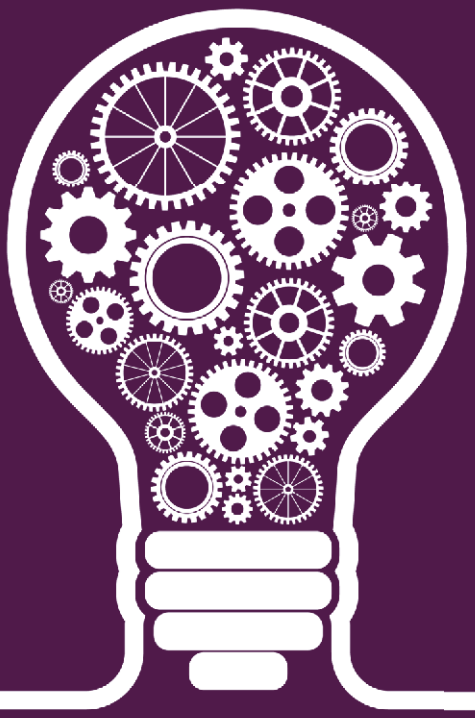

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{ FUTURE LEADERS }

AGNES FAVILLIER

Will Brexit be an opportunity or a setback for the next generations of treasury leaders?

Agnes Favillier is chair of the ACT Future Leaders in Treasury group

As a young treasury professional, Brexit represents the single most impactful political and economic event that I have witnessed. It is also a decision to leave an arrangement that I cannot remember not being part of.

Now this decision has been taken, we are all trying to understand what it will mean for the future. It is a very difficult assessment to make, and even after negotiations start and finish, we will only realise the long-term impact of Brexit in the next 10 to 15 years.

By then, the current treasury leaders will have been replaced by my generation of leaders. What will this mean for us? Will Brexit be an opportunity, making us approach business in new and better ways, supporting our organisations better than we do now? Or will Brexit impact us negatively and hold us back on the things we could have achieved if we had stayed in the EU?

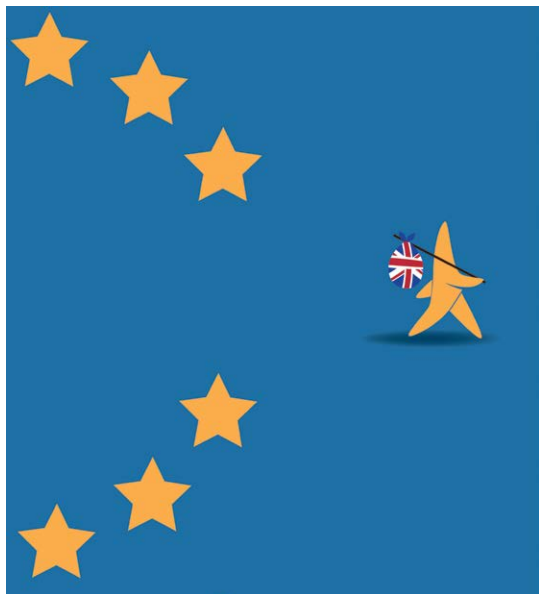
I think Brexit will impact the next generation of treasury leaders positively and negatively.

Most economists foresee a slowdown in business trading and consumption. I'm not an expert in macroeconomy, but intuitively, it sounds right. UK businesses may start to see their revenue and profit fall, and cut costs to offset worsened trading performance. In my view, there lies the biggest risk for the next generation of treasury leaders: as budgets get squeezed, treasurers will need to do more with less, and operate with a smaller budget, often meaning smaller teams.

What about the impact of Brexit on treasury activities and processes? It is only speculation at this stage, but what would be the impact on FX and interest rate risk, cash and banking, funding, compliance, tax and so on? On the cash management side, will it become more difficult or costly to pool cash cross-border, due to tax or regulatory changes? Will it be more difficult to attract funding from European investors? Will all the investment made to comply with European Market Infrastructure Regulation be proven worthwhile?

All these questions cannot be answered at this stage, and we will only understand the full implications of Brexit on the medium term, but what seems clear is that life as young treasury professionals know it, is likely to change.

Which is where I think the opportunity lies: change is good! If the future treasurers' budgets get squeezed and we need to do more with less, treasury teams will have to find ways to become more efficient and effective, automate processes, and let go of processes that do not create value and consume resources. As competition for budget and projects will increase, only the projects with the highest rate of return will be approved, overall increasing the quality of standards and processes in treasury, and in the business.



SHUTTERSTOCK

Treasury teams will be asked to work with the business to unlock value from how the business operates. For instance, potential difficulties in pooling or repatriating cash will actually force the business and treasury to look at their cash and banking strategy, and design and implement the best solution for the business.

As cash becomes an even bigger priority for businesses, treasury will need to really understand and predict the business's cash cycles, leading to improved cash-flow forecasting processes through a better collaboration between treasury and the business.

The next generation of leaders may also have to become more visible externally, and be more involved in the regulatory debate, to ensure that any potential changes don't wipe out previous initiatives and that future changes also benefit them as a business.

Brexit will undoubtedly bring change and, therefore, treasuries and businesses will need to ensure they become more efficient and better adapted to how the UK will operate outside of the EU. For future treasury leaders, the skill that will be critical to success is leadership. Indeed, treasurers will need an acute sense of leadership in order to develop a vision and strategy adapted to a new environment, and to drive the implementation of small- and large-scale projects. Leadership skills take time and effort to develop, and as future leaders, young treasury professionals should start developing those now.

Brexit will undoubtedly bring change, and treasuries and businesses will need to become more efficient

SWITCHED-ON TREASURY

Working in structured finance requires treasury to be close to and understand the sales and marketing side of business. Group treasury manager Rahul Daswani discusses how communication is the key in making this a success at Microsoft

Words: **Ben Poole** / Photography: **Grant Bishop**

While studying to become a chartered accountant, it became apparent to Rahul Daswani that a career in public accounting or audit was not where he pictured his future professional life.

"Many people enjoy roles like that, looking at a transaction after the fact, seeing what went wrong and providing a report," says Daswani, who today is group treasury manager – structured finance at Microsoft. "But I wanted to have a career where I am part of creating those transactions rather than auditing them. That was what led me to join a corporate, initially GE Capital, unlike many of my colleagues."

Having a customer services and operations role at that company, Daswani learnt the fundamentals around operations and finance that would go on to be his specialised field. Moving to Citibank, he took on various roles, including work around credit risk management and product development. "The core of my work started to revolve around financial risk analysis and the study of financial statements," he says. "That was when I decided that corporate finance was the area in which I would like to develop my career. Following that path, I moved to Nokia and then, through acquisition, to Microsoft."

Technology trends

Microsoft has a hybrid structure with most functions centralised in Redmond, in the US, while some of the sales support functions like credit services and structured finance are located around the world. Being a technology company, its teams are technically savvy and use Microsoft's own Azure cloud platform across all its treasury applications.

In structured finance, the clear goal is to support the sales organisation to sell more by addressing credit risk and the liquidity needs of the company's customers and channel partners. This is achieved through use of third-party balance sheets.

When the sales and marketing organisation requires support, Daswani looks at what the issues are and how a solution may be possible. "Once we have assessed that there is a realistic solution possible, my role is that of a project manager," he says. "I put all the stakeholders together, get the product from the banks, explain it internally to get the appropriate approvals from legal and accounting, and then execute the transaction by designing the operational process. It also means that I need to train the operational team, who will continue operating it going forward, so I have oversight of this."

Funding feasibility

Structured finance as an entity at Microsoft was established relatively recently, demonstrating the company's understanding of the need for the types of solutions it offers. This is particularly the case for sales in emerging markets that may not have the same macro environment as some of the developed markets.

"Credit risk is a very important element, but we are obviously still exposed to some credit risk after putting a funding structure in place," says Daswani. "We look at whether we have been able to help our sales organisation by doing a transaction that they would not have been able to do without our structure. We also look at the pricing dynamics to see whether it is viable or not. In addition to the financial

RAHUL'S TOP TIPS FOR SUCCESS

1

"It is important to view banks as your partners and stakeholders. Some of the best solutions emerge when we actively listen and seek out creative ideas from our banking partners."

2

"Ongoing education is a really important concept if you are going to be successful in treasury. My ACT studies have personally helped me to take concepts and use them in dialogue with stakeholders to properly express my point of view."

3

"You have to have the latest smartphone. If you don't, then you may not be as productive, as it really helps with multitasking. And I'm not just saying that to promote Microsoft!"

4

"I worked in many different roles before I entered treasury, moving horizontally to areas such as operations, quality, bank operations, risk management and business development. That allowed me to learn lots of different skill sets. This is good to do early in your career before you have to really specialise. It helped me to get a better perspective of how companies operate and not have a fixed mindset."

5

"I try not to have a fixed mindset. I want to learn and understand different points of view. This can be a challenge. In many areas I am quite opinionated, so sometimes it can be difficult to detach my opinion and hear someone else's point of view, but it is definitely something that I always strive to do."

6

"The most difficult question my boss could ask me is one that will come up during an appraisal: what is the impact you have made? This is a serious question that requires some introspection. You need to understand what value you personally bring to the organisation, and be able to articulate this by describing the challenges you have faced, the effort you have put in and what that will lead to. It is something you should always be thinking of."

7

"It can be hard to wind down in the 24/7 work environment, but it is important to find that time where you can. I like to sit down with my two young daughters and hear from them about how their day went."

ROI, this may include looking at the time you would spend putting the transaction together, the scalability of the transaction and how replicable it would be in the same geography or in another market."

Enhanced cash flow is a valuable side effect of some of these structured transactions, but it is not a key driver. Growth in revenue and supporting customers and channel partners remains the key focus.

"I work with a relatively small team in structured finance, and each of us contributes to the discussion on how we can develop the function," says Daswani. "We look at what we do in one geography and see how that can translate to other areas around the world. The fun part of this role is that we can share strategy and the way in which we conduct these transactions. Things will always be different if you compare Brazil, China, and Dubai, for example, but if there is a way to take a successful mode of operating from one market to another, we will certainly investigate how to do this."

Communicating the benefits

Like many large global organisations, Microsoft has a central corporate plan that is translated down to the broader field organisation – essentially a blueprint for success. Whether that success comes or not depends on how the company executes the plan. "You need the resources and also the cutting-edge technology to achieve this group-wide communication," says Daswani. "We make our own tools like Skype for Business and SharePoint, so you could say that we have a built-in advantage here."

Communication allows everyone to understand the broader company strategy and, more importantly, how their team's goals relate to that broader strategy. Also, closer ties between the treasury function and the business allow the value that treasury adds to the organisation to be clearly seen, and vice versa.

"Treasury is recognised within the company as a career that requires specialised skills, and so treasury qualifications are very important," says Daswani, who achieved his AMCT qualification in 2015. "The company also encourages us to take on certain roles outside of treasury in different functions of the organisation, in order to get a better understanding of the business. Staff are then encouraged to come back to treasury and share their experiences."

Daswani describes studying for the AMCT as one of the best decisions he has made, and for more than one reason.

"I was studying for the AMCT some 10 to 12 years after I'd graduated. It really helped me refresh my concepts. There were also parts of the AMCT that were completely new to me, so I was absolutely brought right up to date."

The fact that he was studying for the AMCT alongside his corporate treasury role was also a benefit. "When you study these concepts, they are very real when you are also practising them in your day job," explains Daswani. "A good example of this is the capital asset pricing model – you don't actually appreciate that until you spend some time trying to do things around it in the real world. Then you understand how you can make the most out of it in your day-to-day work."

Middle East markets

Being based in Dubai, Daswani has a prime view of what is happening in the financial markets of the Middle East. Naturally, the topic of oil is never far from the surface.

"The development of financial markets in the Middle East has frankly been quite slow; for example, there is no good bond yield curve," says Daswani. "One reason for this is the advantage that the oil economy has provided to this region. Higher oil prices provided government revenues that could then be invested in a broad range of projects. Today's lower oil prices are changing the status quo – but it could actually be helpful in the development of the financial markets. Most governments will have to borrow in the near term to manage their investments, which could help to boost the financial markets. Countries such as the UAE and Saudi Arabia seem to understand that oil volatility is here to stay, and are now working on regulation and policies focused on key strategic goals to provide a sustainable financial model."

For treasurers operating in the region, or looking to expand into it, there are a couple of points that Daswani highlights as particularly worthy of attention. The first relates to receivables and credit risk management. "This is something that treasuries operating in the Middle East really need to own; it is the most challenging area of business in this region," he says. "This is best managed by treasury, as it allows the treasurer to make longer-term strategic decisions that impact the cash flow of the company. Choosing the structure and the way we function is vital. In the longer term, this will reduce risk, allowing for lower loss provisions to be made that will impact the profit and loss."

The second point to note is on funding and FX. Many countries in the Middle East, such as Saudi Arabia and the UAE, are linked to the US dollar. This has a tendency to reduce an FX risk element in people's minds. "You also need to remember that the dollar depth in these markets is fairly limited," states Daswani. "You may think you are in a dollarised economy, but then any time you want to raise any sort of financing, it comes at a much higher cost, particularly if you want to do longer-term US dollar financing. It is very difficult to benchmark pricing, as the bond markets are not very well developed and yield curves are not very well established."

In this scenario, treasurers need to spend a lot of time negotiating terms, conditions and pricing, for example. "It is not as transparent as you would expect, even if the currency is linked to the dollar," says Daswani. "Then there are certain countries that are not at all linked to the dollar, which bring their own FX challenges. This is unique to the Middle East market."

> "Treasury is recognised within the company as a career that requires specialised skills, and so treasury qualifications are very important"

VITAL STATISTICS

$85.32bn
Microsoft net revenue

$16.79bn
Microsoft net income

38%
YOY growth of net income compared with 30 June 2015

114,074
Staff headcount worldwide

122
Countries with Microsoft subsidiaries

1975
Year in which Microsoft was founded

All statistics taken from the fiscal year ending 30 June 2016

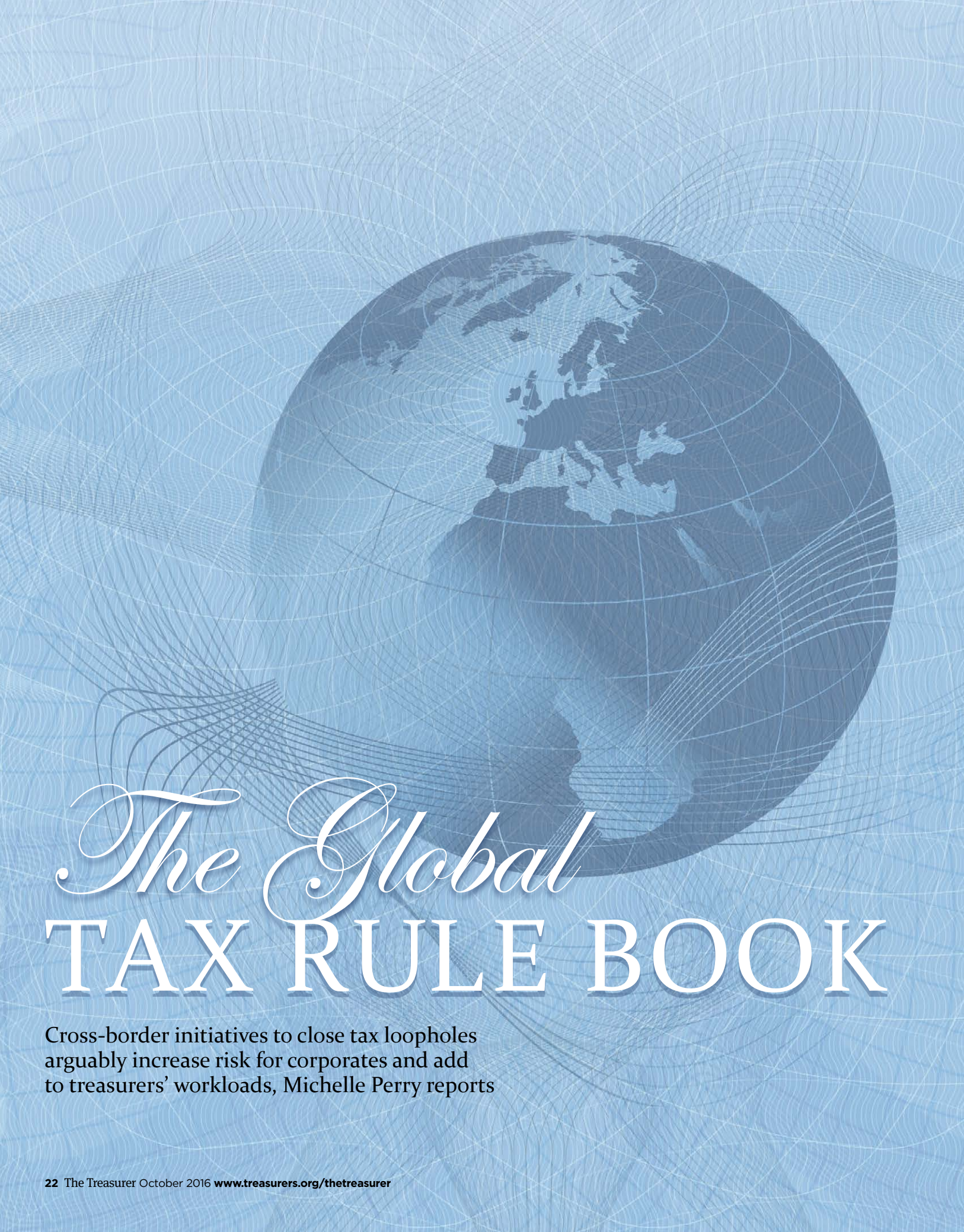
RAHUL'S CV

January 2015-present
Group treasury manager – structured finance, Microsoft
July 2012-December 2014
Regional treasury manager – India Middle East & Africa, Nokia
September 2011-June 2012
Manager, local treasury – India, Nokia
December 2009-August 2011
Customer finance manager – India & South East Asia Pacific, Nokia
December 2007-December 2009
Customer finance manager – India, Nokia
November 2006-December 2007
Business development manager – microfinance, Citibank India
August 2004-October 2006
Regional credit manager, Citibank India
October 2002-August 2004
Banking service and operations manager, Citibank India
January 2002-September 2002
Quality black belt, GE Capital International Services
December 1999-December 2001
Operations manager, GE Capital International Services

QUALIFICATIONS

2013-2015
AMCT: CertRM, CertCFF and CertITM, ACT
1996-1999
Associate of Chartered Accountants, Institute of Chartered Accountants
1994-1997
Bachelor of Commerce (H), Delhi University

Ben Poole is a freelance writer and editor, specialising in treasury and transaction banking



The Global TAX RULE BOOK

Cross-border initiatives to close tax loopholes arguably increase risk for corporates and add to treasurers' workloads, Michelle Perry reports

Modern international business practices have long outgrown the global tax rules for which they were intended. Designed in the 1920s, there is little doubt that the global tax framework has exceeded its sell-by date, but forging international consensus to build a new one has been no easy task.

Over the past decade, governments have made attempts to close loopholes in domestic tax laws. Governments around the world, including the UK, have imposed a general anti-avoidance rule. Last year, UK tax authorities introduced the diverted profits tax (DPT) – also dubbed the 'Google tax'. Plans for an EU financial transaction tax (FTT) were introduced in 2013 to "temper irresponsible trading" following the 2007/8 credit crunch, but member states are struggling to reach consensus.

In the background to domestic attempts, G20 nations realised that unless an effort was made to work collectively, multinationals bent on reducing their tax liability would continue to find ways to do so.

The push to reform international tax laws has been somewhat aided and abetted by the media and a growing public awareness and interest in how much tax multinationals like Amazon, Google and Starbucks pay in certain jurisdictions. For their part, multinationals, despite defending their records and doing nothing illegal, have realised that their reputations are at risk and have begun working with authorities to pay more tax.

"Since the 2007/8 financial crisis, the trust in institutions, both government and business, has been eroded," says James Lockyer, development director at the ACT. "People have looked for someone to blame, and tax is the one issue companies have not been particularly transparent about."

With a growing political will to tackle tax avoidance, three years ago, G20 governments and the Organisation of Economic Co-operation and Development (OECD) launched the base erosion and profit shifting (BEPS) project with the aim of curtailing aggressive tax avoidance. The OECD has produced a 15-point BEPS action plan to which, as of July 2016, 85 OECD members have signed. G20 finance ministers, including then UK chancellor George Osborne, endorsed all 15 action points.

"The OECD has created a menu so that governments can pick and choose without being seen as anti-business. It allows governments to change tax laws relatively uncontroversially. And OECD countries mostly have an interest in cooperating on this," says John Cullinane, tax policy director at the Chartered Institute of Taxation.

The temptation to act independently of these kinds of initiatives can be hard to resist. Last month, the European Commission said Ireland must recover €13bn from Apple, a sum it regards as tax avoidance. This kind of breaking ranks is clearly problematic, but the Commission says Apple's arrangements with Ireland amount to state aid. And yet Ireland, the Netherlands and Luxembourg have already agreed separately to close loopholes in their corporate tax arrangements.

Despite the desire to stem the tax leakage from government treasuries, the fall in tax income cannot be entirely put at the door of multinationals' creative tax planning. Since the financial crisis, economic growth has fallen and, with it, the amount of tax due. So governments have been trying to balance the need to ensure they receive the correct amount of tax due, while also making themselves attractive to investment. Many governments, including the UK, have done this by reducing their corporate tax rates, as well as attempting to curb tax avoidance.

"Some countries are looking to lower their corporate tax rate, but broaden the tax base. While wanting to tighten tax law to reduce avoidance, countries are trying to make themselves seem attractive places to invest in," says Matthew Rose, vice president – tax at Seadrill Management Ltd.

With US multinationals among some of the biggest culprits for aggressive tax avoidance, tax authorities there have updated their own tax laws, introducing the Foreign Account Tax Compliance Act (FATCA). The US Treasury has also implemented new country-by-country tax (CbC) reporting laws from 1 January 2016. Other OECD countries are due to introduce CbC reporting – action 13 in the OECD BEPS project – next year.

The UK has already taken action on CbC reporting, meaning that from 1 January 2016, all UK-headquartered multinationals and UK subsidiaries of foreign-owned multinationals are required to provide HM Revenue & Customs (HMRC) with information about global activities, profits and taxes annually for each tax jurisdiction in which they do business. The Treasury expects to raise an extra £5m in tax in the first two years following the introduction of the new tax rule, and an extra £10m in the years thereafter.

"Some companies will already be struggling with it [country-by-country reporting]. It is a disclosure issue, but you have to consider your situation and the picture that it gives. HMRC thinks it will influence behaviour and not just disclosure," says Paul Johns, director treasury and tax at international construction services company ISG plc.

Action points

The UK government has also introduced new measures to deal with hybrid mismatch arrangements – action 2 of the BEPS project – which typically give rise to a tax deduction without a corresponding taxable receipt, or more than one tax deduction for the same expense. The aim is to eliminate the unfair tax advantages and to encourage businesses to adopt less complicated, cross-border investment structures.

The BEPS guidance on action 4 limiting net deductions for interest to

> "The OECD has created a menu so that governments can choose without being seen as anti-business. It allows governments to change tax laws relatively uncontroversially"

a percentage of a company's earnings before interest, taxes, depreciation and amortisation (EBITDA) is causing slightly more consternation than other OECD actions. To meet this, the UK would need to introduce a new general rule for restricting interest, which would be a major change to the UK corporate tax regime, but it also runs the risk of capturing companies that do not pose a risk of avoiding tax by benefiting from the measure.

In its latest submission to the government's consultation on capping tax relief on interest on debt, the ACT says: "BEPS is a poorly targeted tool intended to affect global multinationals, but, in fact affecting purely domestic businesses, which have a history of using debt capital to achieve growth and government objectives for development of UK infrastructure."

One of the biggest concerns of BEPS is that companies in multinational groups are increasingly using leverage and interest to avoid tax. However, more often than not, the choice between debt and equity financing within a multinational group are commercial decisions rarely based on pure tax considerations, but on legal requirements, regulatory constraints, contractual limitations and foreign currency implications.

Any company that is thinly capitalised will be heavily impacted by the new rule on capping relief, on interest on debt. It is, however, doubtful there are many companies that are accruing so much interest on debt that it is taking up all of their profits. And if that were the case, experts say, those companies are very likely facing serious problems anyway.

It is worth noting that the amount of tax planning in respect of debt is very different in today's world of record low interest rates compared with that of more than a decade ago when interest rates were in double digits. The opportunities and benefits of structuring debt based on reducing tax through interest relief are far fewer in an environment of historically low interest rates.

The current time frame for the UK to introduce the measure is April 2017 – a plan that many are less than happy about. The ACT has expressed caution at the planned timing, because it would mean that the UK would be "an early adopter" of the tax rule, "which remains under development, and before understanding how trading partners intend to implement the initiative".

The OECD guidance includes the option for countries to consider introducing a group ratio rule in combination with the fixed ratio rule. Depending on the design of such a rule, it could ensure that no restriction arises for domestic groups and stand-alone companies in respect of interest paid to third parties.

A big concern for treasurers is that there will be little consistency in interpretation, application or in the timing of BEPS measures across OECD countries

What is important to note is that few of the measures in the OECD BEPS project are entirely new to the UK tax system. Treasurers and heads of tax at multinationals will already be familiar with many of these types of taxes, such as withholding tax (WHT) and transfer pricing rules.

On BEPS action point 6 on treaty abuse relating to royalty WHT, the UK has announced its adoption of three measures. The first is an anti-abuse measure with immediate effect, to deny treaty benefits when royalty payments are routed through a connected company in a treaty jurisdiction to gain a tax advantage.

The other two measures extend the scope of the WHT regime for royalties to include intangible assets – such as trademarks and brand names. The regime will also apply to royalty payments connected with the activities of a UK permanent establishment of an overseas company.

The DPT, which is similar to BEPS action 13, is a new tax charged at 25% on profits that are considered to be artificially diverted from the UK to a related company with a low tax rate. HMRC updated tax law on this point last year.

"The DPT forces everyone to consider their group transactions and in particular the transfer pricing position, along with any risks and whether they need to notify HMRC. It's not inconsistent with the substance of BEPS initiatives, but it is slightly different," Rose says.

Implementation

Despite the familiarity with the concept of certain types of tax, the workload is not to be underestimated. "It's a mammoth task. All of these new regulatory issues that affect treasury involve data capture and you have to change your systems to manage that," Johns says.

SUPPLY CHAIN IMPACT

The OECD BEPS initiative, and in particular country-by-country (CbC) reporting, is likely to have an impact on some companies' supply chains given that most of the action points required by the BEPS project involve greater transparency through increased disclosure.

What this means in practice is that tax authorities around the world will be able to see exactly where a company makes its profits, how much tax it is paying in each country versus profits made, and how much business activity there is in a particular jurisdiction.

Shared service centres (SSCs) in particular are likely to come in for closer scrutiny by authorities. Over the past two decades, SSCs have become a useful tool in better management of the supply chain. Groups have sought to centralise sales, procurement or finance, for example, to reduce duplication and increase efficiency through reorganising resources and sharing investments between business units.

Often, reducing a group's tax liability – not necessarily corporate tax, but perhaps personal taxes – has been a factor in this decision-making process. Such a decision may have been made for clear commercial reasons, but with CbC reporting, the intracompany charges will be magnified. If a business unit were to show big profits but little activity, then tax authorities will likely question the structure.

The new tax rules will involve a significant amount of work for treasurers in terms of compliance and reporting, and even though some BEPS measures are still under consultation, the direction of travel is clear so treasurers and tax teams can get to work in preparation for what is likely to come.

"My view is that the response to BEPS initiatives may be that many authorities will introduce strong tax laws that could be perceived as taking a sledgehammer to crack a nut," says Rose, who is also a former treasurer and head of tax at Royal Mail.

A big concern for treasurers in general is that there will be little consistency in interpretation, application or in the timing of BEPS measures across OECD countries.

"What companies would ideally like is as much advance clarity on proposed legislation as possible to give time to restructure or reorganise transactions where necessary. Tax authorities need to think about the impacts on companies, but also take into account public perception for action on tax. However, for multinational groups operating in many countries that may introduce a variety of rules at different times, it could result in there not being enough time to restructure everywhere. That's clearly not helpful," Rose says.

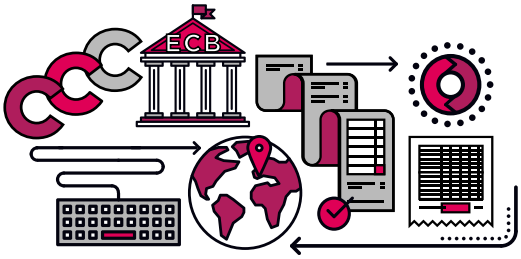
Governments are treading a fine line in their desire to increase their tax income, but avoid penalising legitimate business practices and simultaneously ensure they remain attractive to inward investment. It is a balancing act, especially considering all the other huge political and economic decisions facing business over the next few years.

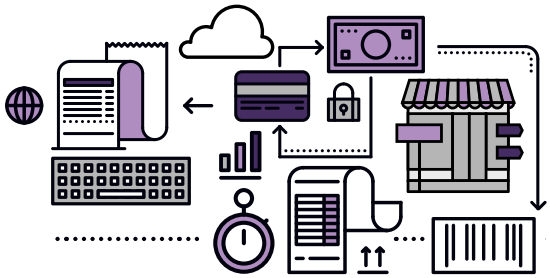
"What companies would ideally like is as much advance clarity on proposed legislation as possible to give time to restructure or reorganise transactions where necessary"

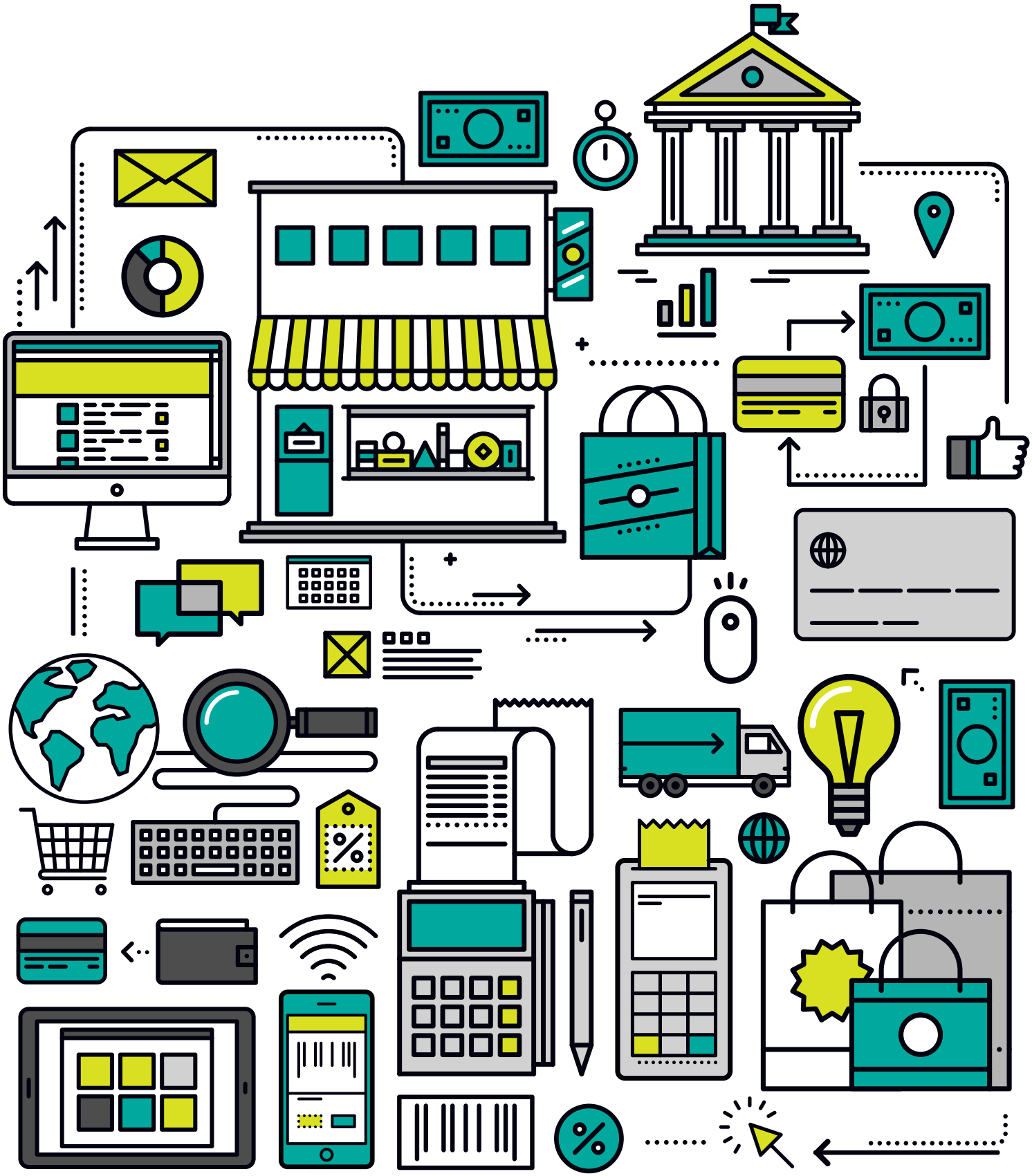
Michelle Perry is a freelance business and finance journalist

CASH & LIQUIDITY MANAGEMENT

14-PAGE SPECIAL







MEANS OF EXCHANGE

Payments technology is fruitful territory for innovation, and new solutions add speed and efficiency, but a genuinely revolutionary approach is some way off. Rebecca Brace looks at developments

Last year, the Payments Council reported that electronic payments had overtaken cash payments in the UK. While cash continued to be used for 48% of transactions, other payment methods – such as debit cards (26%), direct debit (10%) and credit cards (6%) – together represented more than half of transactions. This trend is expected to continue: the Payments Council (relaunched as Payments UK in June 2015) also predicted that by 2024, only 34% of consumer payments will be made in cash.

Meanwhile, the area of payments is evolving rapidly. From mobile payments to blockchain, new technology is reshaping the way that people and businesses transfer money. While some of these developments are already in use, others are more nascent. Innovation is also breathing new life into traditional payment instruments, from the launch of polymer notes to the development of mobile cheque-imaging services.

Embracing revolution

Against this backdrop, to what extent are treasurers taking advantage of the opportunities currently presented by the changing payments landscape?

"From a business perspective, we are seeing corporates reap the benefits from innovations like contactless cards and Faster Payments, especially where they deal with consumers directly," comments Natalie Willems-Rosman, head of payables and receivables, GTS EMEA, Bank of America Merrill Lynch. "However, in general, there is still ground to cover when it comes to both consumers and businesses fully embracing the benefits new technologies have to offer."

Areas of focus include B2B payment systems, while debate continues about the role that distributed technology could play in correspondent banking. In more established developments, treasurers should also be asking whether they can leverage the UK Faster Payments Scheme more effectively.

"There is still ground to cover when it comes to both consumers and businesses fully embracing the benefits new technologies have to offer"

Faster Payments

Launched in 2008, Faster Payments was one of the world's first real-time 24/7 electronic payments schemes. Last year, it processed 1.24 billion payment transactions with a value of £1,104bn.

Mike Banyard, head of development for Faster Payments Scheme Ltd, says there are some interesting use cases for Faster Payments that are driving tangible benefits to businesses and their customers: "From insurance companies seeing a competitive advantage by being able to settle claims immediately (no more waiting for the cheque to arrive) through to consumer-lending firms being able to deliver the proceeds of a loan request within minutes, or firms that are moving to 'just in time' stock management – ordering and paying for goods only when they actually need them," he says.

These advantages are not always fully realised. "For many corporates in the UK, up until now, Faster Payments has mainly been seen as a 'get out of jail' card to play in exceptional circumstances, such as a delay in payroll or supplier payment submissions," says Banyard. "This has been, at least in part, because taking advantage of the immediacy of such payments could require changes in business processes, IT systems and service propositions."

B2B payment systems

B2B payment systems represent another interesting area of development. Carl Sharman, senior director in Deloitte's Financial Advisory practice, notes that there are three types of B2B payment systems:

- Those that replace the traditional role of the bank (ie M-Pesa);
- Those that work with banks to provide a service that banks can offer to their own customers (ie mobile payments and non-financial counterparties, prepaid cards, Faster Payments); and
- Those that use the automated clearing house (ACH) system to process payments (ie supply chain finance multi-bank platforms, such as Orbian and GT Nexus).

According to Sharman, M-Pesa is the benchmark for bank disintermediation. However, he questions whether this scheme has global scale, having evolved to fill a need where the existing bank infrastructure was poor.

"The fastest growth potential is in supply chain financing intermediaries that facilitate dynamic payments discounting on a large scale through multi-bank platforming, as part of a wider working capital management programme," he says.

"Already some huge multinationals are choosing these platforms over single-bank proprietary systems."

Distributed ledger technology

The possible applications of this technology are certainly interesting. "Distributed ledger has great potential to bring enhanced features to the payments landscape," says Matthew Davies, co-head of product management, GTS EMEA at Bank of America Merrill Lynch. "Some of these include the ability to carry more data and, therefore, make it easier for organisations to reconcile payment information and use data effectively."

Davies adds that distributed ledger technology allows for transactions to be settled more quickly and around the clock, and more easily across geographies. "These features could potentially be very beneficial for corporates and can open up all sorts of opportunities off the back of having real-time payment confirmations across the globe, such as entering new markets."

However, it is important to note that these benefits may not materialise any time soon – despite significant attention given to this topic in the past couple of years. As Willems-Rosman says: "It will take time before we have a clear view of how new technologies, such as blockchain, could be fully embedded in the payments landscape, as the industry is focusing on how they can be delivered in a secure, tested and integrated way."

"Everyone gets very excited about blockchain, but it's interesting to cut through the hype," comments Ruth Wandhöfer, global head regulatory and market strategy, treasury and trade solutions, at Citi. "There are a lot of areas where people are probably under the impression that blockchain technology is already extensively being used in financial services to transfer financial assets. This is really not the case – apart from Bitcoin."

She adds: "Various players in the blockchain space have reassessed their proposition and begun to embed features of this innovative technology,

such as distributed consensus mechanisms, rather than replacing existing financial market infrastructures and processes altogether, for example, in the correspondent banking space."

Gaining ground

Much is changing – but how significant are these new developments compared with traditional payment methods?

Sharman argues that technology such as UK Faster Payments and mobile payments represent evolution rather than revolution. "The same single-ledger banking system applies (ACH) – but these recent developments in technology enhance the customer experience, making it faster and easier to access it," he explains.

"For example, Faster Payments artificially speeds it up, as banks take on the risk through collateralisation. So if a payment fails in the traditional clearing process, the claim is against the bank that has guaranteed it. Hence, there are upper limits on transaction amounts to match the banks' collective appetite for risk."

Sharman notes that mobile and internet systems, such as PayPal and Paym, add a layer of security by attaching email addresses and mobile numbers to bank details, or by using new passwords. This enables consumers to access their accounts in a different way.

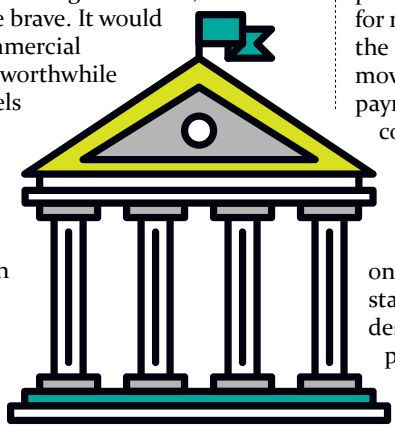
"Consumers get better access to their accounts to pay and receive cash, but essentially with upper limits dependent on the risk the new provider(s) is prepared to take," he says.

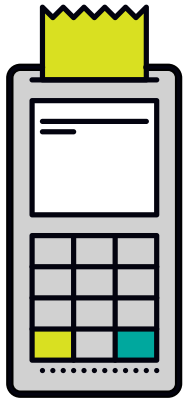
Blockchain technology, in comparison, offers a genuine revolution by promising a new way of accessing value exchange. However, no system is infallible. What is more, banks "have a very strong

> "The fastest growth potential is in supply chain financing intermediaries that facilitate dynamic payments discounting on a large scale through multi-bank platforming"

incentive to collaborate" because of the potential costs they could face as a result of disintermediation, Sharman argues.

"My hunch is that non-financial applications will lead the way – documentation exchange, for example," says Sharman. "Once these are considered foolproof, the step can be taken towards value exchange. However, early adopters will be brave. It would take a move into commercial payments to make it worthwhile on scale, and the levels of trust needed are huge. And as the cost of accessing traditional (evolutionary) methods erodes, then the touted benefits may be significantly smaller by the time the technology is considered viable."





Regulatory developments

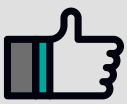
Meanwhile, regulatory developments, such as the revised Payment Services Directive (PSD2) may support further innovation in payments. "PSD2 and changes in interchange fees will further promote change and demand for real-time services – and the PSD2 may support the move away from cards for some types of payment," comments Banyard. "There could also be significant implications for the use of direct debits in future as end users seek greater real-time control over their finances."

The industry is currently working on an enhanced common ISO 20022 standard, which is specifically designed to handle real-time payments, he notes. "This will have a major impact on the speed at which cross-border immediate payments will materialise," he says. "Opinions differ on when this will become a reality, but commercial pressures will push this along faster than we might expect, certainly a lot faster than SEPA implementation."

At the same time, the UK's Payment Systems Regulator is currently consulting on draft guidance, which looks at how access is given to certain regulated payment systems. "The consultation is looking at what users want, how access to markets can be improved, whether this needs to be done through collaboration or competition between people, and how best to enable that," explains Shaun Kennedy, group treasurer of Affinity Water. "I think we'll come through this consultation with a definite plan for the UK and hopefully some innovation will come to the fore."

Payments technology is evolving rapidly. Some of the most significant changes currently being developed may take many years to come to fruition. In the meantime, however, there are plenty of opportunities for treasurers to gain a greater understanding of new and recent developments, and explore how these can be used to their advantage.

CUSTOMER CHOICE



Shaun Kennedy, group treasurer of Affinity Water, says the utility offers up all payment methods regardless of how long they have been in use. "It's really important not just to think about people who've got mobiles and are using all the latest gadgets and apps, but also to make sure that the payment systems continue to serve those who don't have access to, or feel comfortable using, the latest technology," he says.

Kennedy notes that there has been a lot of innovation around mobile payments in emerging economies, such as Africa and China, which have skipped ahead of the UK in some ways. "WeChat, for example, is fundamentally a messaging service, but the way people are using that to make payments to each other is really interesting."

For Affinity Water, meanwhile, some of the most interesting developments include those relating to direct debits. "Direct debit has been around for nearly 50 years, but some developments may be happening here, too," says Kennedy. "If I'm a customer who gets paid on an ad hoc basis, you might take the direct debit, but I might not have any money that day – so the direct debit will bounce. One possibility is for the concept of Request to Pay. A company sends me a request for £30 for my water bill that month and I can say: actually, I'm not going to accept it today, but in two days' time, when I know I've got money, I'll release the payment. That idea has been talked about for a while and will hopefully become a reality."

At the same time, the ability to include more detailed information could make it easier for companies to match up incoming payments with the relevant bills. "As a water company, we get payments from lots of people, but we don't always know what those payments are for, because not everyone includes their account reference," Kennedy explains. "The ability to interact more through the payments system would be useful – for example, by allowing customers to send a picture of the water bill alongside the payment. I think it will be interesting to see how that develops going forward."

Rebecca Brace is a freelance journalist specialising in corporate treasury and banking

THE ONE TRILLION EURO OPPORTUNITY

A detailed look at the cash conversion and working capital issues for European companies reveals a mixed picture, says Andrew Bale

The year 2015 was not a bad one for the top European companies tracked in REL's Europe *Working Capital Survey*. The average cash conversion cycle (CCC) of the 960 companies surveyed shrank 1.7% year-on-year as receivables and payables both improved.

However, some causes for concern remain. Revenues came at a higher cost than in 2014, with gross margins slipping an average of 13.8%. The earnings before interest and taxes margin fell steeply (-22.1%), and debt rose 8.3%. There was a 2.9% increase in cash on hand, outpacing revenue growth (+2%) and Europe's GDP (+1.9%).

One trillion on the table

Net working capital improved relative to revenue growth, only 0.2% against 2% revenue. However, few companies have focused steadily on improving their working capital management. Overall, Europe's largest and most sophisticated companies still have an opportunity to release nearly one trillion euros (€981bn) now tied up in working capital, the equivalent of 6.7% of European GDP (€4.63 trillion). Better management could represent significant benefits in each area of working capital (payables, €349bn; inventory, €328bn; and receivables, €304bn).

Despite the good macroeconomic news, only 13.2% of the companies surveyed managed to sustain improvement in their CCC for three years in a row. Indeed, 9% suffered deteriorating CCC performance for three years running. Nor did cash conversion efficiency (CCE, which measures operating cash flow/revenue) improve much: CCE showed only marginal improvement for the third time round. Despite those slight gains, CCE is still down 3.4% from where it was five years ago, and the average European firm has yet to recover to its 2009 position.

Ultra-low interest rates (0.6%) on loans from the European Central Bank (ECB) are a key cause of their distraction. Total indebtedness has increased from €2.26 trillion to €3.13 trillion since 2010; and, in the past year alone, has risen by 8.3% as companies have taken advantage of the ECB's nearly free money.

Much of this money went either into capital expenditures, M&As or dividend payments. Capex grew by 5% (€28bn) in 2015, particularly in biotechnology (+78%) and internet software and services (+54%), although there were declines in energy services and equipment (-23%), and metals and mining (-14%). M&As were at a record high, particularly in the pharmaceuticals, biotechnology and consumer goods sectors. Dividend payouts grew by 5% year-on-year, increasing substantially in pharmaceuticals, telecommunications and beverages, and continuing a seven-year growth streak.

SCORECARD METHODOLOGY

REL's *Working Capital Survey* calculates working capital performance based on the latest publicly available annual financial statements of the largest listed non-financial companies with headquarters in Europe. This year, the survey included 960 companies. The survey takes an industry-based approach to ranking companies according to the four key working capital metrics: days sales outstanding (DSO), days inventory outstanding (DIO), days payable outstanding (DPO) and cash conversion cycle (CCC). For each industry, the companies are ranked according to overall CCC, and the top three and bottom three performers are listed in the scorecard.

Companies are classified according to the industry classification system and data sourced from FactSet. For purposes of the survey and presenting results, we have grouped certain industries together. Historical comparisons within the survey are made on a like-for-like basis. Where off-balance sheet arrangements are used by the company, adjustments have been made to the data in order to provide true, consistent and comparable figures.

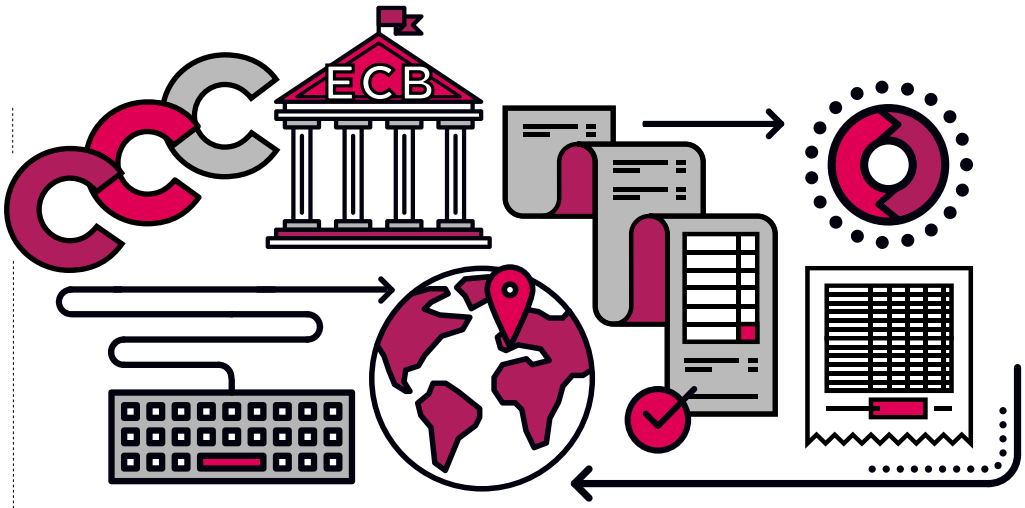
Days sales outstanding (DSO) = accounts receivable/(one-day revenue)
- **Year-end trade receivables net of allowance for doubtful accounts, divided by one day of average revenue**
- **A decrease in DSO represents an improvement, an increase, a deterioration**

Days inventory outstanding (DIO) = inventory/(one-day cost of goods sold (COGS))
- **Year-end inventory balance divided by average days COGS**
- **A decrease is an improvement, an increase, a deterioration**

Days payable outstanding (DPO) = accounts payable/(one-day COGS)
- **Year-end trade accounts payable balance divided by average days COGS**
- **An increase in DPO represents an improvement, a decrease, a deterioration**

Cash conversion cycle (CCC) = (DSO + DIO - DPO)
- **Year-end DSO + DIO - DPO performance (in days, as calculated above)**
- **The lower the number of days, the better**

DATA SOURCED FROM FACTSET/FACTSET FUNDAMENTALS



Companies currently hold the rest of the cash, the equivalent of 11% of revenue. They have a total of €833bn in cash on hand, but the holdings are far from evenly distributed: just nine companies account for €164bn, 20% of the total.

But as the many US companies that have also piled on low interest debt this year are learning, even nearly free money comes at a price. European companies that added 50% or more to their debt in 2015 suffered a 20% increase in their CCC. Slower conversion and an upward trend in total debt (with above-average overall debt and lower average cash on hand for these companies) suggest that European companies have made themselves much more vulnerable in the event of a major shock or disruption to their business.

Countries and sectors swing further

The 1.7% average improvement of all the companies surveyed encompasses much sharper positive and negative sectoral and regional swings.

Industry leaders included companies in marine shipping, which saw their CCC improve to -9 days in 2015 from -1 day; internet software and services, which rose to -5 days from 4 days; and household and personal care, which climbed to 2 days from 6 days. The most dramatic negative changes were suffered by companies in internet and catalogue retail, which fell to -3 days from -11 days; wireless telecommunications, which dropped to -75 days from -91 days; and wholesale distribution, which lost two days, rising to 14 from 12 days. The largest nominal loss was semiconductors and equipment, which added 17 days to its CCC total, bloating to 157 days from 140.

Country performance also varied dramatically. Belgian companies in the ranking topped the list for CCC with -9 days, a six-day improvement in overall performance in 2015, followed by Spain (9 days) and Portugal (10 days). CCC stragglers include Finland (77 days), Sweden (72 days) and Ireland (57 days). Both Belgium and Spain have longer payment terms with suppliers. However, Belgium has higher inventory levels than Spain, but better-performing customer payments. High inventory levels and less advantageous customer and supplier payment terms have given Sweden and Finland the highest CCC in Europe.

It's worth noting that the regional best performers have all improved in recent years. Belgian companies, for instance, saw their CCC rise to -9 days from -3, and the Spanish CCC two-day gain to 9 from 11 days. Overall, only four of the 18 countries tracked by REL improved their CCC over the past five years: France, Greece, Portugal and Spain. This is cause for concern, as it appears that these countries have focused on working capital only once they were in the midst of the European debt crisis. Companies based in other at-risk countries shouldn't draw the wrong lesson from their example; after all, it's generally easier to fix the roof when the sun is shining.

{ KEY FINDINGS FOR 2015 }

€981bn The amount tied up in working capital among companies surveyed

1.7% The average amount the cash conversion cycle shrank across the companies surveyed

20% The increase in the cash conversion cycle for those companies that added 50% or more to their debt

13.2% The proportion of companies that improved cash conversion rates every year for the past three years

Opportunity amid crisis?

What should companies expect this year? The likeliest scenario is for more CCC improvement. As we forecast in 2015, we believe that the trend towards faster cash conversion will continue. However, if, as expected, many of the largest European companies continue to gorge on debt, their overall risks will increase.

Improving working capital practices is always a good idea, but with the ongoing uncertainty that seems likely to follow the Brexit crisis, and no guarantee that interest rates will remain low, 2016 may be a particularly opportune time for companies to reduce borrowing and concentrate on generating cash through tighter working capital management. At the very least, it seems prudent to strengthen internal processes and policies around working capital to enable sustainable cash-flow improvement and to minimise the cash impact of any potential deterioration in trading conditions.

What should companies expect this year? The likeliest scenario is for more CCC improvement

Andrew Bale is associate principal at REL

CASH STASH

Since the global financial crisis, corporates have amassed cash in the billions. Are they being recklessly prudent or is caution now a fundamental part of the business landscape? Paul Cowdell takes a closer look

Many financial managers appear to be sitting behind a wall of cash. Ostensibly, this is a necessary precaution for the benefit of their organisations in an uncertain environment. It is also a very expensive precaution, one that contradicts traditional ideas about returning surplus cash to shareholders if there are no positive net present value (NPV) projects available.

Agency theory suggests that some managers are tempted to be 'recklessly prudent' or overly cautious for career or personal reasons, ahead of the interests of shareholders. But what's the truth of the matter?

Cash mountain origins

Cash hoarding by companies seems to have started around the year 2000, which coincides with the bursting of the dotcom bubble.

In the run-up to the millennium, during a boom in IT shares, investors began to take a 'this time it's different' stance, apparently persuaded that traditional business valuation fundamentals had ceased to apply. Stock markets worldwide peaked in the wake of the dotcom experience. Then, in early 2000, reality reasserted itself and technology stocks lost about 60% of their value. This was accompanied by a decline in stock markets worldwide, as illustrated by the FTSE 100, which traded at 6930 towards the end of 1999 and today, almost 17 years later, is currently still trading below that figure.

Where are we now?

Traditionally, treasurers would manage liquidity on the debt side by techniques such as revolving credit facilities (RCFs). However, since the global financial crisis and the development of Basel III, RCFs are not as attractive to banks. Consequently, corporate treasurers who can't offer attractive ancillary business face a combination of reduced availability and/or higher interest and fees for RCFs. Hence, many treasurers now manage liquidity via a combination of cash and debt.

So, while some may argue that treasurers tend towards being overly cautious, that caution is a product of today's business environment. Since the global financial crisis, treasurers have concluded that they cannot always rely on the bank facilities being there when they need them. Thus, corporates worldwide continue to build up large cash balances.

The US has some striking examples. US businesses collectively have currently amassed around $1,900bn in cash on their balance sheets. Specific examples include:

- Alphabet, Google's parent company, which has on its balance sheet cash amounting to $80bn, around 16% of its total market capitalisation. The $80bn is enough to fund the purchase of a controlling interest in Goldman Sachs or American Express.
- General Motors has cash holdings amounting to nearly half its market value, and Apple's balances are almost a third of its market value.

What's the future

Is this situation likely to change in the near future? In a word, no. A survey by the Association of Financial Professionals shows that the recent trend and forecast trend is for cash balances to increase.

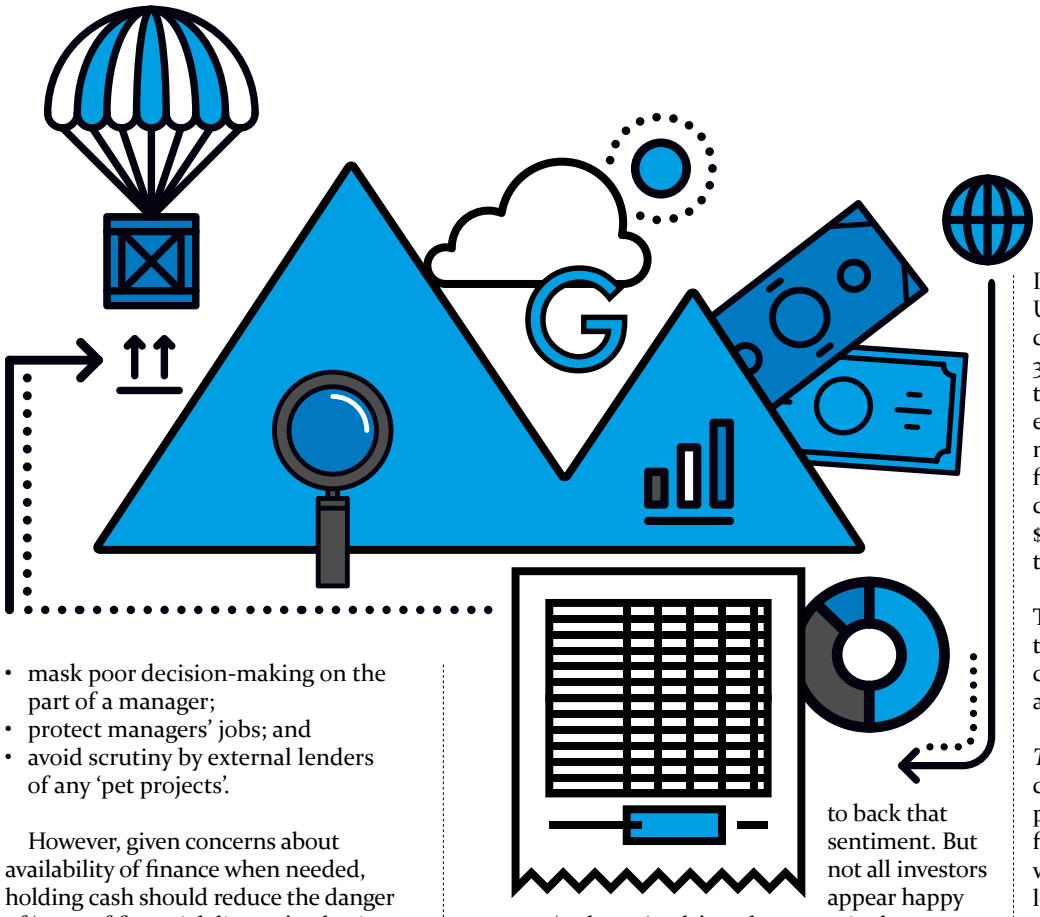
Change in cash holdings	Jul 16	Apr 16	Jan 16	Oct 15
(Over the past year)	+14	+10	+15	+13
Expected change (during current quarter)	+16	+7	-1	+8

SOURCE: AFP CORPORATE CASH INDICATORS JULY 2016 (WWW.AFPONLINE.ORG/PUBLICATIONS-DATA-TOOLS/DATA-TOOLS/AFP-CORPORATE-CASH-INDICATORS)

The indicators measure recent and anticipated changes in corporate cash balances by calculating the percentage of survey respondents reporting an increase (or expected increase) in cash holdings minus the percentage reporting a decline (or expected decline). The survey's authors comment: "Declining indicators are indicative of increasingly confident businesses. Conversely, rising indicators suggest growing pessimism."

So what does this say about traditional financial theory? According to agency theory, the build-up of cash balances serves to:

Corporate treasurers who can't offer attractive ancillary business face a combination of reduced availability and/or higher interest and fees for RCFs



- mask poor decision-making on the part of a manager;
- protect managers' jobs; and
- avoid scrutiny by external lenders of any 'pet projects'.

However, given concerns about availability of finance when needed, holding cash should reduce the danger of 'costs of financial distress' or having to dispose of assets at fire sale values.

Returning surplus cash

Another traditional tenet of finance theory is that if there are no positive NPV projects available, surplus cash should be returned to shareholders as holding cash, especially in the current low or negative interest rate environment, which will generate far lower returns than the company weighted average cost of capital.

However, today the conclusion is not so clear-cut. Holding cash means that it is possible to make opportunistic takeover bids or exploit a major new investment opportunity. For IT companies, acquisitions are seen as an essential means of keeping abreast of changes in technology and customer preferences. Indeed, it is said that Google undertakes an average of one acquisition a week.

To quote Adam Davidson in *The New York Times Magazine*: "For a company such as Google, this means that investors are behaving as if they trust the executives in these industries, like Larry Page of Alphabet, to be smarter about using that money [ie the cash balances] than the investors themselves could be."[1]

Berkshire Hathaway's $1bn investment in Apple earlier this year would appear to back that sentiment. But not all investors appear happy about Apple's cash mountain, however. Activist investors David Einhorn and Carl Icahn have each campaigned at times in the past for Apple to return cash to shareholders. Einhorn even went so far as to take legal action in 2013.

Investor sentiment is clearly divided on this issue, and much depends on the industry, and on investor confidence in the management.

Research by Rohan Williamson and Lee Pinkowitz, quoted in Davidson's article, suggests that, while in some industries investors support the build-up of cash balances, in other sectors, such as defence and coal, investors valued every $1 of stockpile at a mere 40 cents.

Cost of carry

At face value, it makes little sense to hold cash balances and simultaneously have borrowings, as the cost of carry will inevitably work against the company, and that value destruction effect will be even greater if, as has been suggested, banks begin to charge negative interest rates on them. However, there are two possible explanations of this apparent anomaly.

With Apple, for instance, the vast majority of cash is held outside the US and beyond the reach of the Internal Revenue Service. If Apple repatriated the cash to the US, under current tax law, which may change, it would have to pay about 35% in tax. So long as the US corporate tax law remains unchanged, it is more economical for Apple to borrow any money it distributes to shareholders from US sources than to use its overseas cash balances. In 2014, Apple issued a $17bn bond to fund its buyback, rather than depleting its cash balances.

It's not just tax that has an impact. The other advantage of cash mountains that can be cited to outweigh the cost of carry argument is the buffer they provide against economic turbulence.

As Ben Wright, writing in *The Telegraph*, put it: "The scars from the credit crunch – when banks suddenly pulled their credit lines – are even fresher [than the dotcom crash]. A whole host of companies have since learnt that they can't necessarily rely on the banks being there when they need them and have increased their own balances accordingly."[2]

Bearing all this in mind, and as John Grout, the ACT's former policy and technical director, said when asked about his primary advice for treasurers, it may be simply that the answer lies in the old edict: "fund early and fund long". The rise of corporate cash balances has not changed traditional financial theory, but it does add extra dimensions and nuances that should be considered on a case-by-case basis.

1 www.nytimes.com/2016/01/24/magazine/why-are-corporations-hoarding-trillions.html?mwrsm=Email

2 www.telegraph.co.uk/finance/comment/11375709/Apple-might-need-to-save-its-178bn-cash-pile-for-the-next-rainy-day.html

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SPEED MERCHANTS

Clearing and settlement systems around the world are becoming faster, but research shows that approaches vary. Carol Ann Northcott explains

New research by Payments Canada and the Bank of Canada has shown that countries around the world are making innovative changes to their systems to pave the way for faster payments.

As Payments Canada moves forward with its modernisation strategy, the research looked at how 27 jurisdictions compared to Canada in their response to new technologies, evolving user demands and a changing regulatory landscape. The research, *Clearing and Settlement Systems from Around the World: A Qualitative Analysis*, compared timeliness, access, functionality, interoperability and risk management in payment systems.

The world is getting faster

A major driver for modernisation around the world is the push for faster retail payments systems that deliver funds to the end user in a timely manner.

Most large-value payments systems (LVPS) around the world have already developed real-time processing, but some retail systems are lagging behind. For example, the decision to implement the UK's Faster Payments Scheme (FPS) was made by the government after a review of the payments system's inefficiencies, including the need for faster access. FPS is available day and night all year to support the demands of personal and business customers to move money quickly.

The FPS is an example of an Expedited Retail Payment System (ERPS), which provide interbank clearing and are typically integrated into large-value systems for settlement. These kinds of systems are developed, under construction or planned in 17 of the 27 jurisdictions analysed.

Jurisdictions are also enhancing the timeliness of their retail batch-processing systems by adding intraday clearing and settlement. As a result, all but three countries (Canada, Egypt and Israel)

CHARACTERISTICS OF SELECT ERPS (AND THE E-TRANSFER SYSTEM)

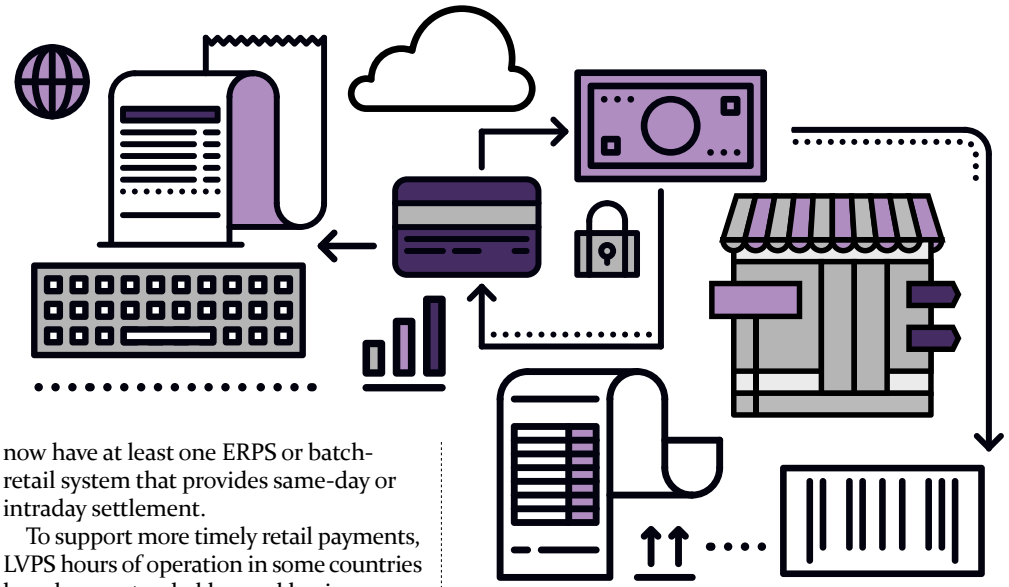
System	Direct central bank role in ERPS processes	ERPS inter-operable with settle-ment system or LVPS	System availability	Wide-use cases for business and consumers	Consumer fees	Value limits[a]	Recipient access to funds[b]
FPS (UK)	✔	✔	24x7	Both	Free	$460,000	Near RT
BiR (Sweden)	✔	✔	24x7	Consumers	Free	None	RT
Straksclearing (Denmark)	✔	✔	24x7	Consumers	Unknown	$100,000	RT
SITRAF (Brazil)	✔	✔	10x5	Business	Nominal	$500,000	RT
FAST (Singapore)	✔	✔	24x7	Both	Bank set	$100,000	RT
RTC (South Africa)	✔	✔	24x7	Both	>$1	$27,500	RT
TEF (Chile)	✔	✔	24x7	Both	Unknown	$13,000	RT
EBT (South Korea)	✔	✔	24x7	Both	Unknown	>$1m	RT
Zengin (Japan)	✔	✔	24x7	Both	Free – $2 (can vary by FI)	>$1m	RT
Express Elixir (Poland)	✔	✔	24x7	Consumers	£0.35 (can vary by FI)	$30,000	RT
e-Transfer (Canada)	No	No	24x7	Consumers	$1-2	$3,000	<30 minutes

a ALL AMOUNTS CONVERTED TO CANADIAN DOLLARS
b REAL TIME (RT) = UNDER ONE MINUTE AND NEAR REAL TIME (NEAR RT) = >1 MINUTE AND <THREE MINUTES

COUNTRY COMPARISON OF LVPS TRANSACTION VOLUME AND DIRECT ACCESS

Country/system	Policy or objectives to increase access	Number of direct participants	Millions of transactions per participant	Core system risk management upgrades
Denmark (KRONOS)	✔	94	0.01	✔
US (Fedwire)	✔	7,866	0.02	✔
Japan (BOJ-NET)	✔	473	0.04	✔
Australia (RITS)	✔	89	0.12	✔
New Zealand (ESAS)	✔	21	0.12	✔ (pending)
Sweden (RIX)	✔	30	0.14	✔
South Africa (SAMOS)	✔	23	0.28	✔
Canada (LVTS)	–	17	0.46	–
Switzerland (SIC)	✔	412	1.04	✔
UK (CHAPS)	✔	22	1.66	✔
Mexico (SPEI)	✔	98	2.68	✔
Mean	0.60			
Median	0.14			

MOST DATA ARE FROM THE COMMITTEE ON PAYMENTS AND MARKET INFRASTRUCTURES, SEPTEMBER 2015



now have at least one ERPS or batch-retail system that provides same-day or intraday settlement.

To support more timely retail payments, LVPS hours of operation in some countries have been extended beyond business hours. Significant changes to settlement systems have been made in Australia, Sweden and the UK to accommodate faster settlement of retail systems.

Participation

A major finding in the research has been that direct participation in core systems is widening. Many jurisdictions have an explicit public policy objective to increase access for direct participants in their batch or retail systems and LVPS. This has resulted in a steady rise in direct participation, along with the need to upgrade technology and improve risk management.

For example, the batch retail system in New Zealand, with multiple settlements a day, was established largely to reduce credit risk to allow international banks to become direct participants. China established more than 268 direct participants in its national automated clearing house when the China National Advanced Payments System was introduced, while managing credit risk with collateralisation and same-day settlement.

Other examples include Mexico's SPEI, which has grown to 98 direct participants, including non-banks, ancillary payment systems and a telecom services provider. The Reserve Bank Information and Transfer System (RITS) in Australia has 89 direct participants, which is up from 67 in 2008.

Enhancing the functionality of retail systems around the world was identified as a clear trend in the Payments Canada and Bank of Canada research. Payment operators are leveraging centralised architecture to implement advanced system capabilities.

We found higher functionality in centralised retail systems, including the ability to sort, validate, route payment batches to financial institutions and interact with other systems. For example, if the system can scan payments for fraud and errors, the participants don't have to.

Interoperability

Systems are becoming more interoperable. There is a trend among the countries studied to move towards more interoperability between systems, which enables automation. For example, TARGET2 in Europe has one of the most interoperable systems identified in the research, connecting to 83 ancillary payment and security systems, and supporting more than 2,000 direct participants across 23 jurisdictions.

The research also found that ISO 20022, a messaging standard, is becoming the most prominent international standard for electronic payment messages. ISO 20022 will help businesses and financial institutions move away from paper by creating the conditions for data-rich electronic payments. ISO 20022, which can be found in EU countries, Japan and New Zealand, can also help streamline cross-border payments by using a common language for payments data.

In Canada, the ability to use rich standardised payments information will save businesses time, and our research released in 2015 on the benefits of ISO 20022 suggests that it could save more than $4.5bn over five years. Payments Canada plans to implement ISO 20022 for its core payment system to improve interoperability and provide more services for participants and end users.

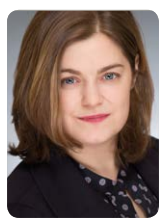
Risk management is evolving

Risk management processes in retail systems have evolved to accommodate interoperable systems, more participants and faster availability of funds. Risk management is being addressed primarily through faster settlement processes and enhanced collateralisation use. Large-value systems are seeing more advanced liquidity-saving tools and real-time monitoring to help mitigate risks. Payments Canada's Automated Clearing Settlement System was designated for oversight by the Bank of Canada in May, which means it will be subject to more stringent risk management criteria going forward.

No 'one-size-fits-all'

Core payment systems around the world have significantly evolved since 2005. Of the 27 countries examined, 24 have redesigned or added at least one core payment system. Of these jurisdictions, 20 have made, or are in the process of making, major changes to more than one core payment system.

However, there is no one-size-fits-all approach to modernisation. Each jurisdiction has modernised based on its own public policy objectives, user needs and legacy systems. What does seem clear is that success is enhanced by taking a holistic, multi-system approach to modernising core payment systems that complement each other.



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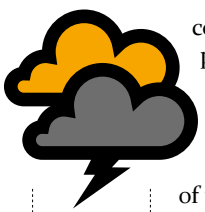
MANAGING WORKING CAPITAL *in* UNCERTAIN TIMES

The EU referendum outcome is likely to prompt treasurers of UK companies to review their working capital management practices. First and foremost, companies need to make sure their own processes are as efficient as possible. Llewelyn Mullooly and Martin Flint explore the issues

In the wake of the Leave vote, uncertainty abounds. For UK companies, this uncertainty has wide-ranging implications – and nowhere is this more evident than in the area of working capital management.

Economic uncertainty can affect working capital management in a number of ways. For one thing, less certain market conditions may render sales forecasts and cash-flow forecasts inaccurate, leaving companies with a funding shortfall or with too many assets on the balance sheet.

Uncertain conditions can also prompt companies along the supply chain to adopt greater caution, sometimes resulting in changes to payment terms or to the timing of payment to suppliers. For other companies, particularly manufacturers, movements in exchange rates and commodity prices will also impact working capital, having a knock-on effect on the cost of raw materials and inventories.



Impact of the vote

Following the financial crisis, many UK companies focused squarely on working capital management, and, based on our analysis undertaken with Markit Economics, this focus appears to have remained in place for a number of years. Positive GDP and more stable economic and financial conditions in the past couple of years may, however, have prompted some companies to shift some of that focus.

Following the referendum, the British pound has fallen against the US dollar by around 12% as of the beginning of August. For companies purchasing goods from overseas suppliers, this type of swing can have a significant impact on the cost of raw goods. The Bank of England's response was to reduce interest rates by another 25 basis points, while increasing government and corporate bond purchases, driving FX rates down even further.

Equity markets may have rebounded more recently – but the continuing uncertainty and mixed economic data are likely to make working capital management a challenge for some time to come. For treasurers, this may be a good moment to review the company's working capital management processes.

Best practices

Working capital is a resource that companies need to manage effectively. Financing working capital comes at a cost, and in a challenging economic environment, this can have a direct impact on the efficiency of assets and the company's return on capital. Reducing the amount of working capital used by the company not only releases cash into the business for other strategic objectives, but can also reduce ongoing financing requirements.

The efficiency of UK companies' working capital practices varies considerably. Our own research, based on the publicly available financial data of around 19,000 companies in the UK, found that the top 10% of companies in terms of working capital efficiency had, on average, twice as much proportional cash from operations as the bottom 10%. In an uncertain market, there is a clear business case for prioritising working capital management.

Effective working capital management involves working cross-functionally within the business and balancing commercial and financial objectives. For example, companies have to balance their need for cash against the importance of maintaining strong relationships with their suppliers and customers. They may also have to consider whether it is better to prioritise making their own processes and operations more efficient, or adopting the financial solutions offered by banks and others.

Working capital focus

While financial solutions can play an important role in supporting effective working capital management, the implementation of those solutions can be limited by a company's available management information and existing business structures and processes within the organisation. In addition, a key challenge when optimising working capital is to ensure that improvements are embedded within the organisation and do not adversely

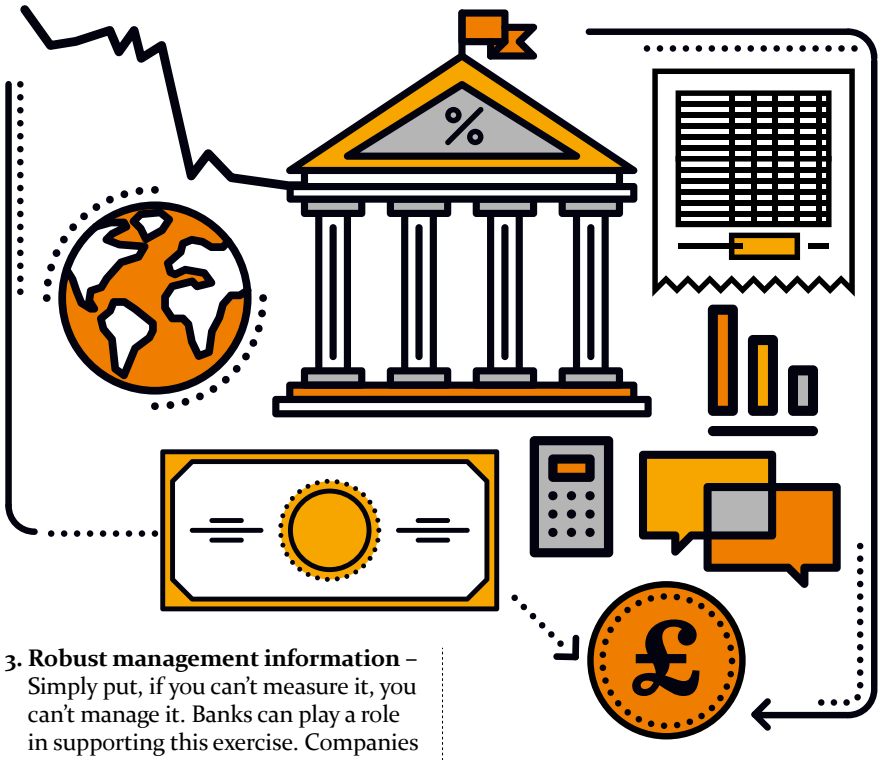
Companies need to ensure that working capital is a boardroom discussion and seen as a finance and business priority

BUILDING WORKING CAPITAL INSIGHTS

Lloyds Bank has been working with Markit Economics to create a UK Working Capital Index through the analysis of macroeconomic data and business performance indicators. The objective is to highlight the drivers and pressures affecting UK working capital cycles, while supporting UK companies in managing this critical resource effectively.

The research carried out just before the EU referendum found that economic uncertainty, including the UK leaving the EU, was one of the top five concerns for UK companies when it comes to working capital management, cited by 19% of respondents. The associated uncertainty over demand and sales volumes was a concern for a further 14%.

While it is early days yet, the possible impact of the Leave vote was illustrated by the survey, with 20% of respondents saying that they expected their customers to take longer to pay them in the coming 12 months.



impact margins, increase risk within the supply chain or damage commercial relationships or reputations over the long term.

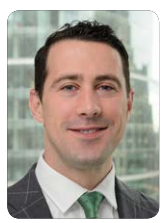
The cross-functional engagement and requirement to balance often competing priorities requires treasurers to think carefully about how effectively working capital is being managed within their organisations. The following are a few key points to consider in light of the current economic environment:

1. **Proper focus** – To be effective, companies need to ensure that working capital is a boardroom discussion and seen as a finance and business priority throughout the organisation. It should be incorporated into planning cycles, agendas, targets, KPIs, investment cases and scorecards – and should also be measured, with metrics managed and shared across the different functions in the organisation.
2. **Governance frameworks** – Clearly defined areas of accountability are needed for influencing and working across functions, as well as regular forums for review and challenge. Only then can companies achieve sustainable improvements.
3. **Robust management information** – Simply put, if you can't measure it, you can't manage it. Banks can play a role in supporting this exercise. Companies can work with their banks to analyse their existing payment and collections processes, and identify opportunities for improvement. A good relationship bank will work with the company to analyse its data and ask whether those processes are as efficient as possible.
4. **Financial solutions** – Treasurers should assess the full range of financial solutions available. In times of economic uncertainty, treasurers should take the time to understand the options available and how they can be deployed to benefit the company. Banks will have numerous solutions available, including supplier financing, asset invoicing and trade instruments, as well as cash management solutions designed to improve companies' payment and collection processes. Meanwhile, the rise of fintechs has led to the development of a number of new technological solutions.

Conclusion

While the longer-term impact of the EU referendum vote remains to be seen, treasurers should be aware of the likely effects of the current uncertainty.

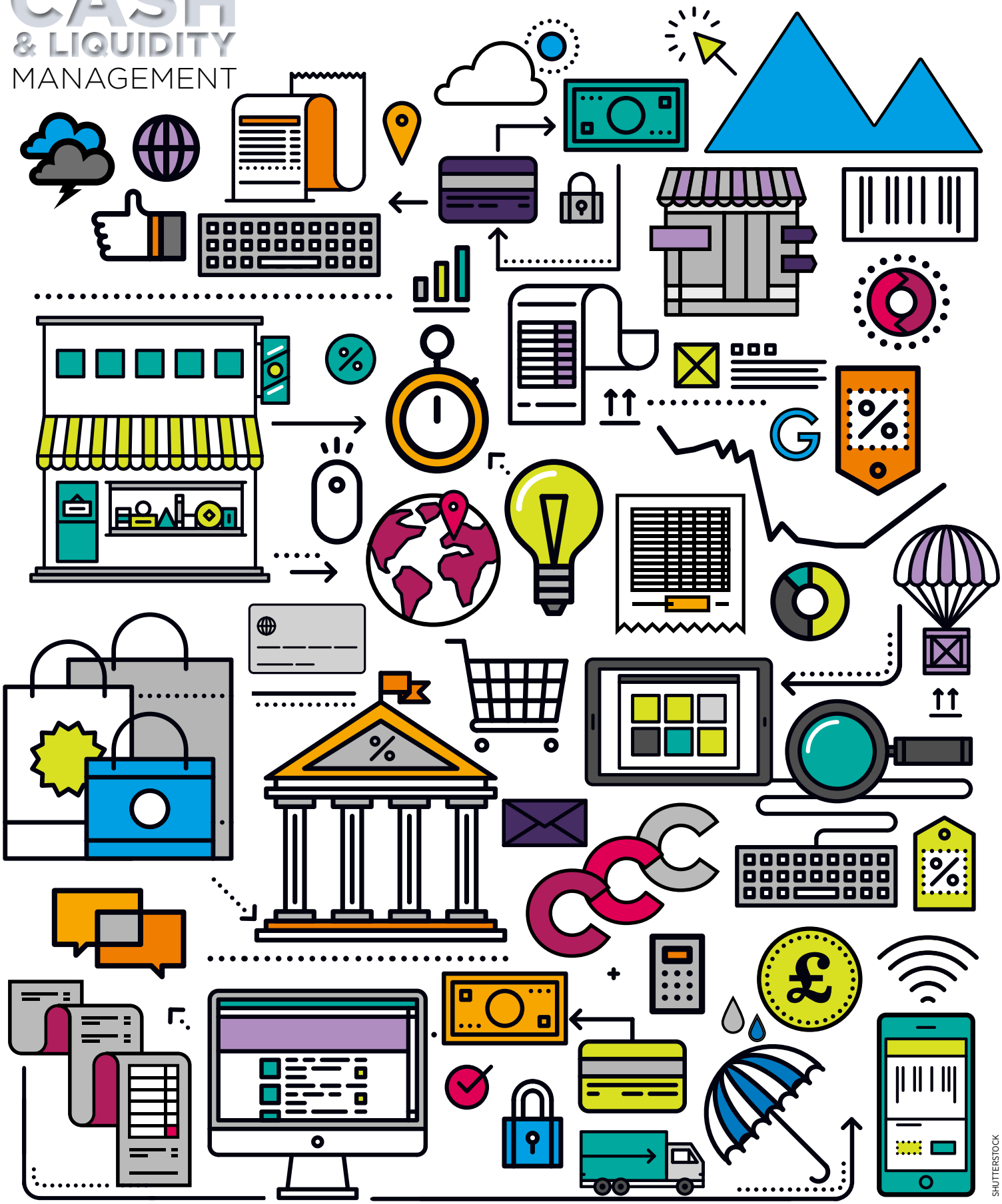
In a low-rate environment, companies may tend to focus less on working capital because they can manage any shortfalls through cheap debt. During times of economic uncertainty, however, there is a greater need for companies to revisit their working capital management strategy. Going into an uncertain environment, the last thing that any treasurer wants is to leave untapped cash in the business. They will therefore be taking the opportunity to make sure that working capital is a priority across the business.



Llewelyn Mullooly (left) and Martin Flint (right) are directors of working capital, global transaction banking, at Lloyds Bank

LLOYDS BANK

CASH & LIQUIDITY MANAGEMENT



SHUTTERSTOCK

Fit for purpose

RISK POLICIES MUST FLEX IF CORPORATES ARE TO TAKE ACCOUNT OF EXTERNAL INFLUENCES, SUCH AS CURRENCY MOVES, OR INTERNAL ONES, SUCH AS ACQUISITIONS. ANH NGUYEN EXPLAINS

On the morning of 24 June, and the weeks following, we spoke to numerous corporate treasurers, who shared the same concerns: "Is my FX risk strategy still appropriate? What actions should I take in the immediate term to protect my financials from further volatility?"

We experienced similar frantic reactions from the global treasury community the morning after the Swiss National Bank broke the peg to euro, or when negative interest rates became a new normal in the eurozone. These concerns are also further elevated for companies that are undergoing organisational or structural shifts, such as an initial public offering (IPO) or M&A.

Across currencies in the Americas, Asia and Europe, the past year and a half has seen more extreme movements beyond two standard deviations – movements that are greater than 95% of statistically expected outcomes. Treasurers and senior management are prompted by the board to explain what steps they are taking to mitigate currency risk in light of unprecedented volatility. From our experience of working with more than 300 corporates globally, a solid foundation of objectives and constraints is the most important compass to navigate uncharted waters and devise risk management decisions. A holistic assessment across all aspects of risk is then required if corporates are to select optimal strategies. Those will then need periodic reviews and updates, particularly in changing environments.

> Risk management objectives need to be specific, well defined and understood

Put objectives first

Risk management objectives need to be specific, well defined and understood across all levels of the organisation. For the majority of companies, having a hedging strategy in place allows them to buy time to react to sudden shifts in the market with appropriate business decisions and smooth FX impact on the financials. In an ideal world, if a company had perfect ability to change its business operations, such as immediately raising sales prices or changing suppliers in response to adverse currency impacts, the company would not need to hedge. In reality, depending on the industry and competitive dynamics, few companies are able to pass currency risk up or down the value chain immediately. The timing cushion, within which the company can be insulated from these shocks, determines the length of the company's risk management horizon and expectations.

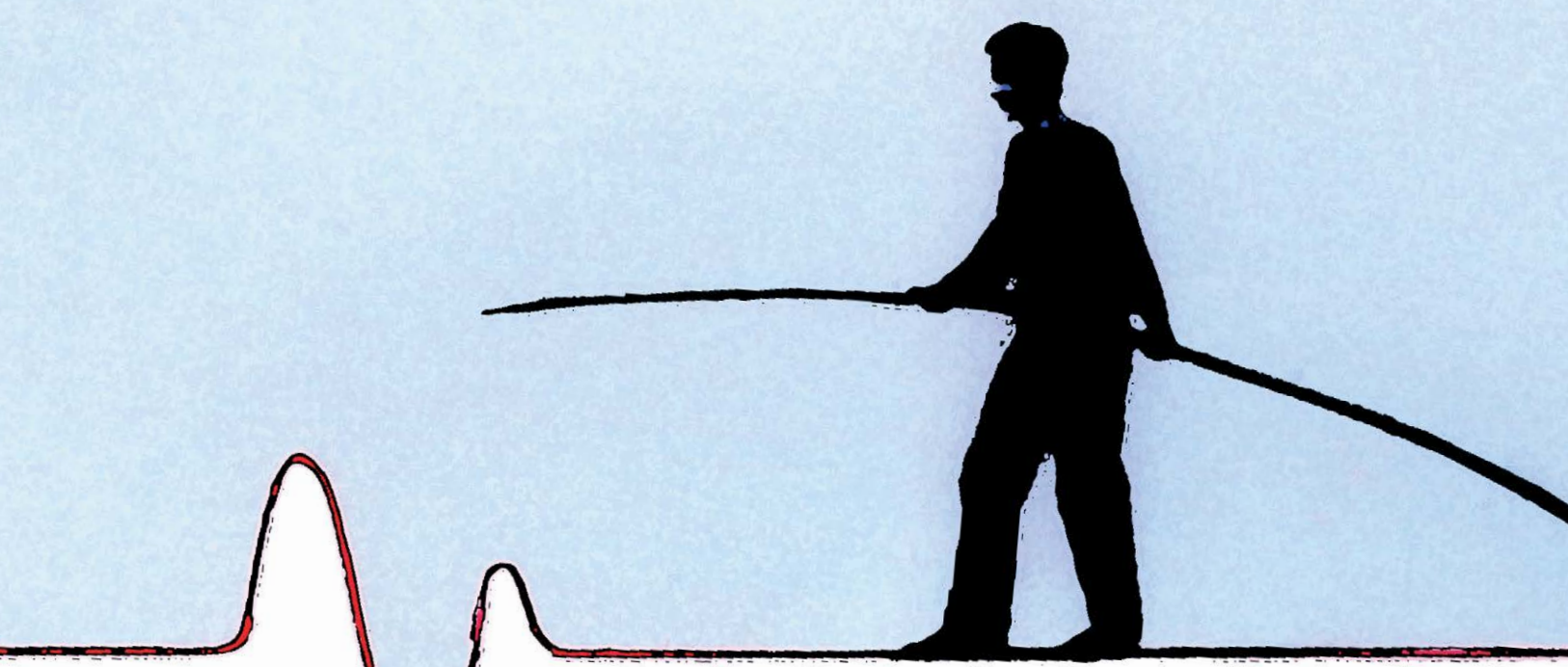
Risk management objectives can change over time as the company experiences organisational shift throughout its life cycle. Impacts on FX risk management approaches due to structural changes in the organisation can be overshadowed by impacts of overnight shifts in external market conditions. While market shocks tend to trigger scrutiny of the company's hedging strategy by the board and investors, more attention should also be paid to how risk management objectives and constraints may change following shifts in corporate structure, such as an IPO or a strategic acquisition.

Such events require the company to reassess its risk tolerance and the sensitivity of its stakeholders. For example, a private company under a single investor's ownership may have a more discretionary view of specific exposures. Once the company is listed, risk management objectives might gravitate towards a removal of financial volatility, given the large base of investors with varying priorities. Similarly, separate entities are likely to have different perception and objectives of risk management that need to be discussed and reconciled upon a merger or acquisition.

Capital structuring and hedging

Strategic capital structure selection can be an effective way to introduce natural offsets to the company's overall risk profile. When used appropriately in conjunction with operational hedging programmes, this approach can provide companies with a more dynamic risk strategy that addresses different objectives and constraints.

An issuance in foreign debt markets (or a synthetic foreign debt via the use of cross-currency swaps) can create a natural hedge: foreign interest payable offsets positive cash flow in that currency on the profit and loss, while the liability itself can be a natural hedge of foreign equity. Operational hedging, on the other hand, is the ongoing hedging of foreign flows generated by the business, to remove volatility in specific financial metrics (for example, EBITDA, net income or covenants). Given the multiple impacts of a single strategy on a company's results, it is crucial that every risk strategy is assessed against specific and well-defined objectives.



For example, a publicly listed company primarily focusing on earnings per share may only reap marginal benefits from foreign debt (via its interest expense netting positive flows in the same currency), whereas a company that cares more deeply about its equity value (for example, to protect investors' equity returns) may consider capital structuring the most efficient tool.

While capital structuring is most appropriate as a longer-term risk-mitigation strategy (for example, three to five years), given the relatively rigid structure of debt, operational hedging can be more dynamic and adaptable to a changing profile of exposures over time. This flexible structure also means that operational programmes are designed to smooth FX impacts over a shorter horizon (for example, a fiscal year), rather than removing risk altogether.

The two approaches, with their respective pros and cons, offer limitless alternatives for designing an optimal policy. They cannot be designed in isolation and need to work in tandem to achieve the level of risk reduction and horizon of risk management defined by the company's objectives. We have seen companies experiencing inefficiencies and unexpected hedging results when capital structuring and operational hedging decisions lie within separate teams, or when there is no holistic assessment of risk profiles across these separate functions. For example, a company may over-hedge its euro net cash flows when hedging forecasted euro EBITDA without taking into account the impact of interest expenses from an existing EUR/GBP cross-currency swap that synthetically converts sterling debt to euro liability.

Policy requires regular review and maintenance

A hedging policy that efficiently addresses the company's objectives, priorities and constraints can be more resilient in the face of changing environments. When confronted with a sudden market shock, the company's approach to natural hedging strategies is less likely to change significantly.

In the shorter term, an operational hedging programme helps insulate the company from this overnight shock, as FX rates are already locked in for the chosen hedging horizon. That said, this benefit is achieved via a sizeable mark-to-market figure, an asset/liability that offsets the FX loss/gain of the underlying exposure to stabilise financial results. A large negative mark-to-market can be emotionally unnerving; in the wake of the EU referendum, we had conversations with companies that considered unwinding their forward contracts to capitalise on the gains, or settle the losses and put on new trades at market levels. These may be discretionary tactics for cash flows and budgeting reasons specific to each company, but might not be straightforward to implement for complex tax and accounting reasons. Moreover, since hedges were put in place to protect certain forecasts against market volatility, there is a strong case for not removing this protection at the most volatile time, unless the nature of the underlying exposures has changed significantly due to this market shock (for example, a re-forecasting is required). In this example, long-term risk management priorities can be overshadowed by foggy market environments, and companies that rely solely on tactical actions may risk no longer having a strategic direction.

In light of recent market shocks, risk management policies should be reviewed to validate whether they are still appropriate and meet set objectives. It should be assessed at what cost these objectives are achieved and whether there are new objectives and constraints that need to be addressed.

With changes in corporate ownership, capital or organisational structure, the company's risk policy should adapt to shifting risk management objectives. Whereas FX used to be a more reactive topic in the larger context of change management in corporate finance and treasury, we have increasingly seen companies taking a more proactive approach to FX discussions at the board and senior management level at the early stage of an IPO, M&A or divestiture in anticipation of shifts in priorities or potential disconnect in objectives and constraints.

In the face of changing environments, we have seen that the three crucial pillars for a resilient risk management strategy are a solid foundation of objectives and constraints, a holistic assessment of potential strategies with both capital structuring and operational hedging approaches, and a discipline of periodic policy reviews and updates.

Anh Nguyen is manager in risk management advisory at Chatham Financial

Chatham Financial

IN IT FOR the long term

RATING AGENCIES AND REGULATORS FOCUS ON INSURERS' SHORT-TERM FINANCIAL STRENGTHS, BUT FOR PENSION PROVISION, WIDER CONSIDERATIONS COME INTO PLAY, ARGUES DAVID WATT

In selecting an insurer, price is an important factor for pension schemes, but it should not be the only factor. Unlike the short-term insurance business, where the consequences of under-pricing quickly manifest themselves, the repercussions for the pension buy-in and buyout business may not be realised for many years. This poses a challenge for pension schemes that are entrusting an insurer to meet the obligation to pay scheme members for the next 50 or more years.

One of the main benefits of buy-ins and buyouts is that the security of members' benefits naturally increases as they move out of the pension's framework into regulated insurance. However, not all insurance companies have the same financial strength, and this should not be overlooked when selecting an insurer.

In the US, the 1991 insolvency of Executive Life, a California-based annuity writer, offers an interesting case study, which ultimately led to a system under which pension plans cannot select insurers that have not first met independently assessed 'safest available provider' criteria, irrespective of the price they can offer.

In the UK, a prudent regulatory framework exists to ensure that insurance companies remain strong, but no such specific requirement exists for buyout providers to be independently assessed against set criteria. To a large extent, pension schemes implicitly rely on rating agencies, the Prudential Regulatory Authority (PRA) and any covenant advice that they take to assess and ensure the financial strength of insurers. The PRA is responsible for the regulation and supervision of insurance companies, while rating agencies consider various criteria in order to provide opinions on the financial strength of insurers in respect of their ability to pay claims to policyholders.

Regulatory capital coverage ratios and rating agency opinions are helpful to pension schemes in assessing the short-term financial strength of prospective buy-in and buyout providers, but what criteria might those schemes and their advisers use to form their own view?

Capital requirements

Insurers hold capital to ensure they can pay policyholders. Under the current regulatory capital regime (known as 'Solvency II'), insurers are required to hold capital that reflects the risks they are exposed to, such that the insurer is 99.5% certain of its ability to pay policyholders over the following year. In practice, insurers hold a range of buffers above this requirement, making failure over the following year theoretically less likely than 0.5%. Because it contemplates a one-year horizon, this measure can drive trustee and other decision-makers' focus on to these shorter-term measures. Over the longer term, considerations, such as the quality, size and diversification of the insurer's balance sheet, are also important indicators.

> However, not all insurance companies have the same financial strength

Balance-sheet quality, size and diversification

Insurers back the pension promises they take on with a variety of investments and must strike a balance between investing with caution and sourcing assets that generate yields sufficient to support competitive pricing. A large, established insurer with a high-quality, well-diversified investment portfolio may in some instances charge a higher premium than those insurers that operate less diversified investment portfolios.

Monoline insurers that focus on a specific product are exposed to a much narrower range of risks than multiline insurers. Pension schemes, therefore, need to decide whether a higher premium represents good value for the additional security offered.

Long-term value

While price will always be an important consideration, trustees and sponsoring companies should also pay close attention to the value of the policy they are buying. The long-term security of the insurer – demonstrated by a large and well-diversified balance sheet – is an important, and often overlooked, point in that value consideration.

David Watt is new business director at Legal & General

Legal & General

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BEWARE THE STATUS QUO

ONCE RELIABLE, CURRENCY PAIRS MAY NOT BE A SAFE BET IN THE FUTURE, AND TREASURERS SHOULD CONSIDER THE IMPACT OF CURRENCY VOLATILITY ON SUPPLIER RELATIONSHIPS, JAMES STRETTON ARGUES

In a volatile world, treasurers need to be careful what they rely on. Relationships and correlations between currencies, which for a long time appeared reliable, have recently shown a tendency to break down. These breakdowns usually occur at a time of general economic stress, and the fallout is often dramatic.

Recently, the most extreme example is the EUR/CHF currency pair. It was floored at 1.2000 by the Swiss National Bank (SNB) on 6 September 2011 and the floor was defended by the SNB selling CHF and buying EUR (see Figure 1). However, the SNB did not 'sterilise' its intervention in the markets – ie, it did not sell government bonds to soak up the extra supply of CHF.

Although this policy could have gone on *ad infinitum* from a pure currency perspective (since a central bank can always turn to the printing presses and never run out of its own currency to sell), from a money-supply perspective, there were always going to be limits to the policy's duration. This is because every unsterilised Swiss franc that was printed added to the Swiss money supply. One of the main reasons for the intervention in the first place was to avoid deflation. However, a spiralling money supply eventually unnerved the SNB, and on 15 January 2015, it abandoned the EUR/CHF floor. This saw the exchange rate plummet by some 30% on the day, and anyone who was relying on the continuation of the 1.2000 floor was suddenly completely wrong-footed.

Another currency pair, the ongoing stability of which it would be imprudent to rely on, is EUR/PLN. Indeed, this may be an accident waiting to happen. Figure 2 shows the history of this currency pair since the euro's inception on 1 January 1999.

The past five years have seen the rate range bound between broadly 4.0000 and 4.5000. Encouraged by Poland's enthusiastic membership of the EU, and the recent relative stability of the exchange rate, some have been prompted to regard the PLN as a proxy for the euro. This could be a very dangerous notion.

Were one or more eurozone members to leave, it is not clear whether the euro would be stronger or weaker – it would depend on who left. A euro without Germany would leave the single currency as weak as a kitten. Certainly, EUR/PLN would be highly unlikely to remain in the 4.0000 to 4.5000 range.

It is not just reliance on correlations that can wreak havoc in corporate treasuries. Many businesses also have loose or formal arrangements with their suppliers or customers to share in the pain or gain from substantial FX movements. Yet, even formal agreements can be subject to hasty renegotiation in difficult times, and loose agreements have a habit of disappearing completely.

For example, in the aftermath of the financial crisis, suppliers of imported food products, who had looked for support from their supermarket customers during previous bouts of sterling weakness, found it very difficult to push through price rises. They face the same problem once again, in that the fall in GBP/EUR since the referendum has occurred against the backdrop of a sharp fall in general business confidence. This, combined with fierce supermarket price wars, means the supermarket buyers are in no mood to help out suppliers by paying more for imported products.

Currency risk

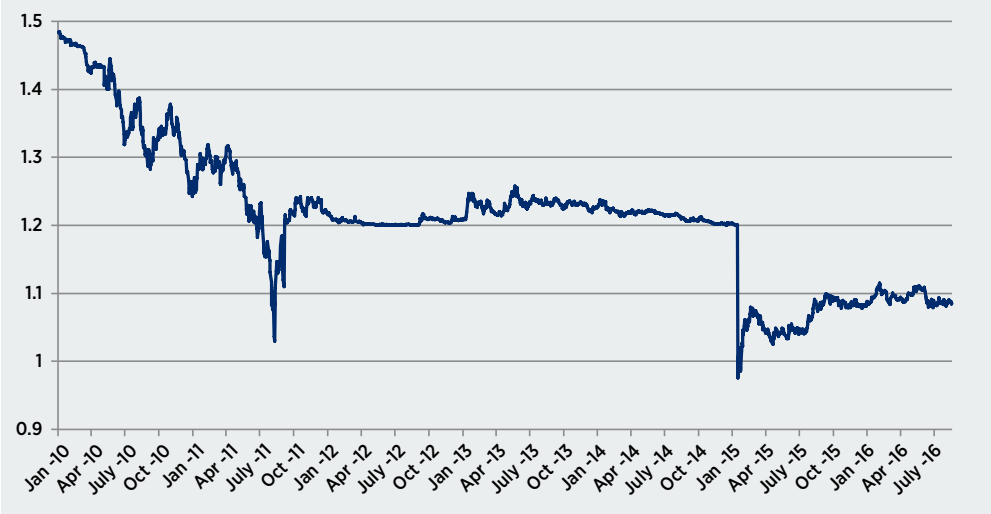
This is the iron law of FX: large currency movements always happen for a reason. In many cases, the underlying cause of the movement will make it even more difficult to cope with, whether it's a financial crisis or an unanticipated political event.

Some companies, perhaps due to a lack of experience, could make the mistake of assuming that since they pay for certain imported inputs in sterling, they are not exposed to currency risk. While this may be convenient in times of stable exchange rates, in the event of a decent downward move of the pound, suppliers will quickly raise their sterling prices in order to maintain their prices in terms of their own reporting currency. The pricing of some manufacturing inputs may be even more nuanced. For instance, a manufacturer using oil-based products from the eurozone is likely to be exposed to the dollar, rather than the euro, since oil is priced in dollars.

As if all of this were not tricky enough, companies have to contend with the competition. Even if a firm manages to avoid being lulled into a false sense of security offered by a particular consensus view and seeks to hedge itself in order to protect against adverse currency movements, it must still consider the actions of its competitors.

IKON IMAGES

FIGURE 1: EUR/CHF, 1 JANUARY 2010 TO PRESENT



DATA SOURCE: BLOOMBERG

FIGURE 2: EUR/PLN, 4 JANUARY 1999 TO PRESENT

DATA SOURCE: BLOOMBERG

Relationships and correlations between currencies, which for a long time appeared reliable, have recently shown a tendency to break down

Importers trading in products that have few substitutes might be assumed to be in the same boat. In the case of sterling weakness, eventually they will all have to raise prices. Although, those who have hedged will be able to hold out for longer and potentially increase market share. However, in the case of sterling strength, the unhedged will be able to pass on some of the benefit to customers, whereas those who locked in to a worse rate will not have that option.

This is a powerful argument for incorporating optionality into the hedging strategy to avoid locking in. For exporters, the situation is often even more complicated, as they may be facing competitors who report in a range of different currencies. A UK producer exporting to Germany may, through a combination of sensible hedging and some ability to pass on price rises, feel comfortable with GBP/EUR risk, only to find that weakness in the Thai baht, for example, suddenly provides the Thai competition with an opportunity to gain market share.

Alternatively, an exporter of goods or services may be competing with domestic manufacturers in the export market, who face little or no FX risk. In this circumstance, sterling strength, if unhedged, could prove disastrous, since, depending on the price elasticity of demand for the export, there may be little ability to pass on currency-induced price increases.

As we have seen from EUR/CHF and longer-term historical movements in EUR/PLN, seemingly stable currency pairs have the potential to surprise. And, it can be perilous to rely on the consensus, as the recent EU referendum demonstrated.

Attempts to share the pain or gain of currency movements with customers or suppliers are often successful when the movements are relatively small and when times are good. However, when movements are large, they are often accompanied by some general economic malaise for at least one of the parties.

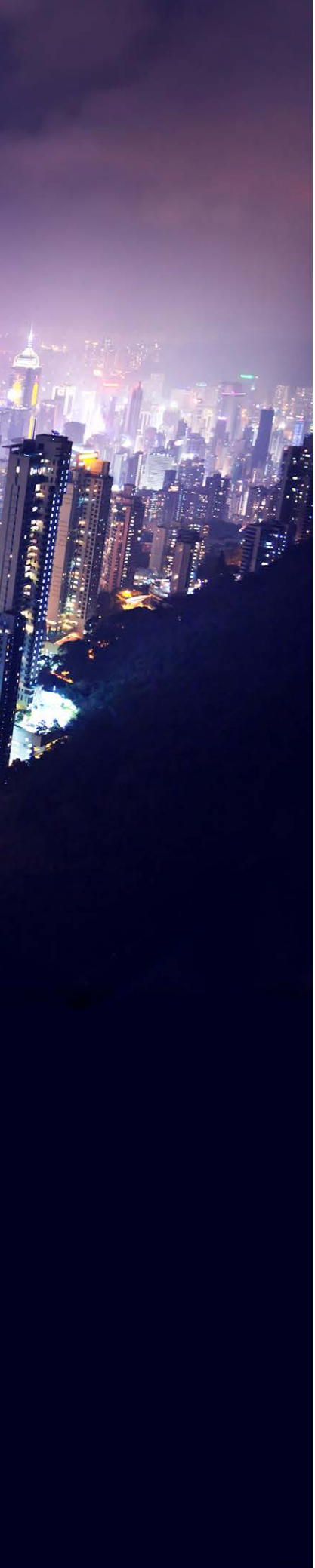
Some companies may be able to reprice when input costs rise or their reporting currency appreciates. Though the ability to do this will depend very much on the market for the product or service, and on competition.

For those operating in competitive markets, neither currency stability nor relationships with customers or suppliers should be taken for granted. In these circumstances, the sensible use of derivatives to create a flexible hedging strategy becomes crucial.

James Stretton is a director at financial risk advisers JC Rathbone Associates. He has nearly 30 years' experience in FX risk management

SAFE HARBOUR

RECENT LEGAL AND TAX CHANGES HAVE HELPED HONG KONG TO POSITION ITSELF AS ASIA'S LEADING TREASURY HUB LOCATION, SAYS JAMES BADENACH



Hong Kong has introduced recent law changes to address the asymmetrical tax treatment of interest income and expense that previously had made it less favourable for regional corporate treasury centres (CTCs). It has also added a half-rate tax incentive with a view to attracting more global and regional CTCs.

Hong Kong is well positioned for corporate groups (both Western multinational corporations (MNCs) and Asian outbounds) to centralise their global and regional treasury functions because of its proximity to mainland China, the largest offshore renminbi pool, well-developed banking system, efficient capital and FX markets, deep talent pool of experienced treasury, banking and asset management personnel, favourable regulatory and tax regime, and sound common law legal system. "The recent tax law changes will make Hong Kong more competitive when global and Asian MNCs look for a location to set up a corporate treasury centre in the Asian time zone," says Vincent Lee, executive director of the Hong Kong Monetary Authority.

There are two key drivers behind the interest in Asia as a base for CTCs. First, the size and scale of Western MNCs in the region have continued to increase as the balance of economic power shifts towards Asia and other emerging markets. "The increased scale of Western MNCs in Asia is resulting in an increased need for the active management of treasury during the Asian time zone and to be closer to the markets to better deal with some of the regulatory and other market inefficiencies that exist in Asia," according to Bonnie Chiu, regional head of sales, global banking corporates, global liquidity and cash management at HSBC.

Second, Asian corporate groups are expanding globally with acquisitions and also maturing in their operations, including their treasury functions. There is a growing recognition and awareness among Asian corporate groups, as they become more global, of the need to centralise the treasury function and the management of cash, to better manage liquidity and reduce funding costs across the corporate group. As these Asian corporate groups obtain better visibility over their cash and debt positions, such considerations invariably turn to the centralisation of the corporate treasury function into a CTC.

According to a recent EY survey of corporate treasurers on global and regional operating models and location selection for CTCs in Asia-Pacific, key factors that corporate groups look into on CTC location selection typically include:

- sophistication of financial infrastructure;
- access to capital markets;
- cost and availability of treasury talent;
- overall tax environment;
- legal and regulatory environment; and
- political stability.

For CTCs actively managing the treasury position (as distinct from service-centre-type CTCs performing, for example, payment processing), aspects such as the legal and regulatory environment, access to capital markets and availability of treasury talent are generally assumed to be a given for a location to be seriously considered for setting up a CTC.

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Hong Kong is one of the most competitive economies worldwide, according to the IMD Competitiveness Center

Why Hong Kong?

Without doubt, Hong Kong has its strengths. It ranks as the world's most competitive economy in the *IMD World Competitiveness Yearbook 2016*, moving up from second place in 2015. It also places third globally behind Switzerland and Luxembourg and first in Asia in terms of availability of financial services in the World Economic Forum's *Global Competitive Report 2015-2016*. Hong Kong has high standards of market transparency, disclosure, prudent supervision and is without exchange controls, all crucial for centralised treasury functions.[1]

"While we are seeing a lot of interest in Shanghai for treasury centres focused on managing the treasury position in China, and an onshore cash pool for renminbi, for a regional or global CTC in Asia, the choice invariably comes down to Singapore and Hong Kong," according to E-May Neoh, Asia head of liquidity management, Bank of America Merrill Lynch. "The location of choice is then decided around a corporate group's current geographic footprint and regional headquarters location, together with economic factors, such as taxation."

Hong Kong is one of the most competitive economies worldwide, according to the IMD World Competitiveness Center, and is already a leading destination for regional and international headquarters and CTCs. Based on the *Report on 2015 Annual Survey of Companies in Hong Kong Representing Parent Companies Located outside Hong Kong*, the number of regional headquarters, regional offices and local offices in Hong Kong rose from 6,948

in 2011 to 7,904 in 2015.[2] Of these, there is a steady growing rate of set-ups with parent companies located in China.

Hong Kong made its intention clear in the 2014 budget of attracting more CTCs to Hong Kong to enhance its position as a leading global international financial centre, a leading offshore renminbi centre, a premier asset management hub and an international capital market. The Hong Kong government followed through with the passing of legislation that addressed the tax asymmetry issue in the Hong Kong domestic tax law and also legislated a tax rate incentive of 8.25%.

The asymmetry issue previously arose where interest expenses paid to overseas non-financial institutions prior to the law changes were not tax-deductible in Hong Kong for a CTC carrying on the business of lending of money in Hong Kong, while at the same time the interest income from overseas lending was chargeable to tax in Hong Kong. "The law has now been changed to address this issue, albeit with certain conditions," says Alice Chan, partner and international tax services leader at EY Hong Kong. "Our clients are now viewing Hong Kong in a different light in any analysis on location selection for their regional or global CTCs. Now Hong Kong is being seriously considered, which bodes well for Hong Kong, given its geographic advantage of being proximate to mainland China."

In addition, Hong Kong has legislated for a tax rate incentive of 50% of the current profits tax rate (ie 8.25%) for qualifying CTCs in respect of a broad range of prescribed corporate treasury services and transactions. The tax rate incentive is relatively wide in terms of the activities that fall within the incentive, however,

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Tax should never be the sole consideration in choosing the location of a CTC

to obtain the incentive may require CTCs to set up in a separate legal entity to conduct the treasury activities.

For regional or global CTCs in Asia-Pacific, Hong Kong and Singapore are generally the preferred locations, and there has been a healthy rivalry between them as global financial centres, with both possessing the relevant attributes for corporate treasurers. Both locations are well positioned as CTC hubs in terms of financial infrastructure, efficient FX market, availability of treasury talents, and sound regulatory and legal framework. Hong Kong has a comparative advantage in its role as a premier offshore renminbi centre and, having close ties with China, better established equity capital market as well as a more extensive network of international corporate and investment banks.

Under the three-tier banking system, Hong Kong has a highly developed banking market, with approximately 70% of the top 100 banks in the world having operations in Hong Kong. Being one of the most active markets for initial public offerings, Hong Kong's stock market was the fifth-largest in the world and the third-largest in Asia in terms of market capitalisation as at the end of April 2015. In addition, Hong Kong's debt market is one of the most liquid markets in Asia. By the end of April 2015, the outstanding amount of the Exchange Fund Bills and Notes was about HK$752.8bn, with a daily turnover averaged at HK$12.6bn.[3]

Tax treaties

In contrast, Singapore is often perceived as better in terms of geographic proximity to ASEAN countries, the availability and quality of treasury talent, a long-standing specific tax incentive for treasury centres (among other favourable tax incentives, including those in the financial services space) and a well-developed commodities market. Singapore also has a larger tax treaty network than Hong Kong in terms of the number of treaties. However, as a result of Hong Kong's active effort to expand its tax treaty network, Hong Kong now has a number of tax treaties offering a more favourable interest withholding tax rate than Singapore. Specifically on the CTC regimes in both locations, the new CTC incentive enacted by Hong Kong does leave little arbitrage between the two locations from a tax rate perspective.

Nevertheless, tax should never be the sole consideration in choosing the location of a CTC. The location should depend on the footprint and business needs of the corporate group and the physical location of the corporate treasury team actively managing the corporate group's treasury, and related treasury and financial risks. Going forward, as a direct result of changes happening globally to the international tax system through the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting project, "aligning the location of the treasury team and the location where transactions are booked will be crucial for any MNC looking to access reduced rates of interest withholding tax under tax treaties, for example, and to manage its transfer pricing risk", says Eng Ping Yeo, EY ASEAN tax leader.

For corporate groups that focus solely on the ASEAN region, Singapore may offer a slight competitive advantage given its geographic proximity; for those corporate groups that have material business activities with or in mainland China and the rest of northeastern Asia, Hong Kong has a distinctive geographic advantage over Singapore. For mainland Chinese enterprises, Hong Kong is unquestionably the natural outbound gate.

The views reflected in this article are the views of the author and do not necessarily reflect the views of the global EY organisation or its member firms.

1 Asia Treasury Trailblazer Summit 2015, Hong Kong Monetary Authority, 30 April 2015 (www.hkma.gov.hk/eng/key-information/speech-speakers/pstpang/20150430-1.shtml)
2 Published by the Census and Statistics Department Hong Kong Special Administrative Region (www.statistics.gov.hk/pub/B11100042015AN15B0100.pdf)
3 *Hong Kong: The Facts* (www.gov.hk/en/about/abouthk/factsheets/docs/financial_services.pdf)

James Badenach is a partner and international tax services leader – financial services at EY Hong Kong

At your service

TREASURY MANAGEMENT SYSTEMS DO NOT ALWAYS BRING HOPED-FOR GAINS IN TERMS OF TIME AND MANAGEMENT RESOURCE. MARTIN BELLIN PROPOSES A NEW MODEL

Treasury management without the use of professional tools to underpin treasury processes seems more and more unthinkable in a modern, technology-driven world. While the specifics may vary, the overall reasons for implementing a treasury system are the same across the board of corporate treasury: streamlining and automating processes; reducing and doing away with manual processes; and boosting efficiency. Treasurers want to be freed of repetitive, tedious manual jobs, such as gathering data from subsidiaries. They want to focus on decisions that bring real value to the company and their implementation.

Digitisation has made things faster, and the world feels smaller as a result. A seemingly inconsequential event anywhere in the world can have huge repercussions for businesses – and this is no longer true for only large multinationals, but increasingly also for smaller companies. Nearly everyone is active on a global level these days, and treasurers the world over are forced to stay abreast of any economic and political developments. They need to think ahead, but at the same time be able to act on the spot if need be. They're the ones managing liquidity; they're the ones hedging risk; and, as such, they're key players in any business. It should therefore be any company's top priority to make sure treasurers have what they need to meet the challenges of their profession and the increased demands globalisation has placed on them.

No one-size-fits-all way to strategic treasury

So how can we best support treasurers in their work? It is important to remember that every business is different and that there may be more than one way of achieving this ultimate objective of treasury: underpinning a company's every financial move and ensuring a sound strategy that safeguards liquidity and boosts profitability – weathering any political or economic turbulences.

Software as a service (SaaS) has made the lives of treasurers much easier: cloud-based systems have allowed them access to group-wide data at the touch of a button, in real time, regardless of their location. This has brought a considerable reduction of treasurers' workloads. Nevertheless, there is a powerful trend towards

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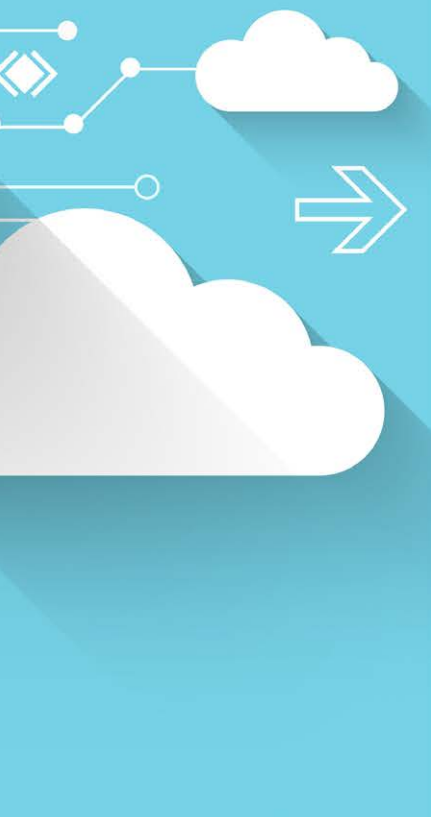
even more automation, and even more focus on the way a corporate treasury adds strategic value to a business.

Even with considerable automation by means of a treasury management system (TMS), companies might still be left with daily tasks that exceed their capacities. Or they may simply choose to focus their energies even more on what they can do with the results a treasury application provides. Whether you have a treasury set up, but would like to spend your time differently; or whether you don't have a treasury, but would still like to benefit from the added value treasury data and management can bring, the key to both can be outsourcing – via Treasury as a Service (TaaS). Echoing SaaS, TaaS goes beyond mere technical support. It aims to meet the very objective of modern treasury even more pointedly: eliminating inefficient and repetitive tasks that can easily be performed by someone else who is familiar with the system and understands treasury processes.



Treasurers future-proof their business – so we need to make sure we future-proof treasurers in the best possible way

While using a TMS does make life that much easier, it is still an application treasurers need to spend time on. It requires implementation, training and maintenance. For some treasurers, it might indeed be time to ask themselves: am I really running my treasury, or am I running my treasury system? Am I putting the data in my TMS to optimum use? What if I could boil things down to the point where I am left with strategic decision-making as my only real 'task'?

We've already mentioned the important role of treasurers for sensitive and crucial financial issues: where is excess liquidity tied up that could be used elsewhere? Which investments are needed and who needs an intercompany loan? Which risks need to be hedged? Or, to put it in even more practical terms, how do I ensure my company is unaffected by any potential repercussions that Brexit might bring? Treasurers need to be enabled to stay on top of these decisions, to have complete visibility and to use their overview to their strategic advantage.

It's the results that count

Treasurers need data and results. They may also want the application, but they may also not. Let's put this in non-treasury terms: who today is still willing to pay for an app on their smartphone? Hardly anyone. It is more or less taken for granted that apps are provided for free. Now, the actual data, the results, are a very different matter. Yes, we might be willing to pay someone for providing us with the information we need to take further action. If someone presents me with the complete results, all neatly prepared and geared towards my requirements, and all I need to do is say yes or no – that represents a service that really makes my life easier and that has real value for me.

The specific treasury services a company might require depend very much on size and strategy. There are a number of non-mission critical and non-core competence processes in treasury. In theory, TaaS can cover any corporate treasury operation and can be made to fit any functionality required. It is all a question of capacity, focus and, ultimately, preference. As a company, you might have certain tedious, recurring treasury processes that you simply don't want your treasury staff spending their time on and allocating their resources to. Or you might have more complex requirements that would mean having to buy in outside expertise. Or you may not even have a treasury in the first place.

TaaS can support any role in a corporate's front, middle or back office, including operative maintenance of master data; regular system-data verification and maintenance; account statement collection and verification; daily financial status reporting; automation control and error resolution; monitoring liquidity forecasting; concluding FX hedges based on predefined hedge ratios; monitoring multilateral reconciliation processes; or performing netting runs. You keep the responsibilities you want to keep (or may have to with a view to compliance), for example, payment authorisation, and outsource everything else – flexibly and accommodating many different corporate requirements and needs.

Using powerful treasury software solutions or outsourcing with TaaS, both options meet the needs of today's business issues, whether it is compliance, risk, corporate development, forecasting, analytics or capital strategy. Treasury has the data, the insights, but also the analyses needed for many possible scenarios, and treasury delivers a sound basis for navigating any economic or political storms. Treasurers future-proof their business – so we need to make sure we future-proof treasurers in the best possible way. Services are the future, and treasury is no different here. Let's build on the achievements SaaS technology has brought us and take the next step. Let's embrace the service component of treasury, and listen to what corporate treasurers really need.

Martin Bellin is the founder and managing director of BELLIN Group

Those that can, share

EFFECTIVE, FOCUSED TEAMS HAVE ACCOUNTABILITY AND A WILLINGNESS TO ENGAGE WITH EACH OTHER AT THEIR CORE. VANESSA HARWOOD-WHITCHER EXPLAINS THE CHARACTERISTICS OF HIGH-PERFORMANCE TEAMS AND SHOWS HOW TO SPOT THE SIGNS OF LESS-EFFECTIVE ONES

Take a small, eclectic group of friends, mix together with some great minds, a garage and a big ambition to change the nature of computing and what do you get? The answer, of course, was the birth of the Apple Mac, the fastest-selling machine that beat any PC created before it.

The story of the now infamous Steve Jobs and Steve Wozniak is widely known, and while one may not think that the most people-friendly leadership skills could be found at Apple, the story is worth examining in more detail when it comes to its team approach.

The brilliant minds that formed the Mac team were incredibly competitive within Apple and externally, with their ambition to beat the other PCs on the market at the time. The team and its leader, Steve Jobs, were single-minded in their focus to create an affordable PC that could be used by non-techies.

This relentless focus on creating the Mac often led to the most stretching goals and deadlines being set, and stories prevail of the caffeine-fuelled, break-free days and nights spent building the prototype.

Of course, this often led to those creative minds having bust-ups and fallouts, some of which were told to dramatic effect in the film *Steve Jobs*.

Spotting a high-performing team

Thinking about one's own experience of leading or working within a team, it is worth taking a few moments to consider what made that team a success or failure. There are often signs that a manager can spot to help them gauge the health of the team they are working in. The diagram below gives some checkpoints for leaders to use to see where their team is strong, and areas on which they can help their team to develop.

Looking back at the Apple example of a team, a few clues start to unravel why a seemingly unorthodox group of people had such success, including: focus, clarity, productivity, stretch and feedback.

What makes a team go wrong?

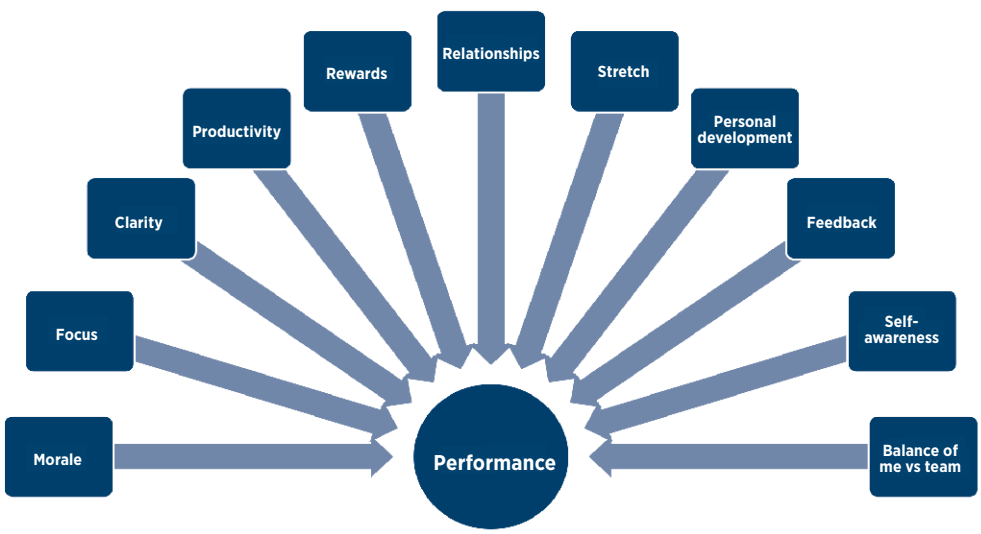
Of course, the Apple team wasn't perfect, as the film depicts. Spotting the signs of an underperforming team can be really helpful to managers.

Author Patrick Lencioni wrote a book called *The Five Dysfunctions of a Team*. The first half of the book introduces the reader to a fictitious management team and the journey of its members together, and the second half discusses the key reasons for team failure. It is an excellent read and recommended for anyone working within or leading a team.

Lencioni explains that there are a number of dysfunctions exhibited by underperforming teams. These characteristics are linked and build from one to another, leading ultimately to the potential of team failure.

So, what makes a team go wrong?

SIGNS OF A HEALTHY TEAM



WHAT MAKES A TEAM GO WRONG?

SOURCE: PATRICK LENCIONI – *THE FIVE DYSFUNCTIONS OF A TEAM*

Characteristic 1: Absence of trust

Typically, teams that have low trust levels come about as a result of team members not being prepared to be vulnerable with one another. This will often manifest itself in people hiding mistakes, not admitting their weaknesses and generally not asking for help.

Characteristic 2: Fear of conflict

When team members do not trust each other, this can often lead to members staying quiet when they disagree, or withhold ideas and contributions that otherwise could benefit creative behaviour. The reason for staying quiet is that it is easier than starting conflicts with colleagues. Often, cliques will form and conversations are had

behind closed doors rather than airing issues as a group.

Characteristic 3: Lack of commitment
When there is no conflict, it is difficult to get issues and ideas out in the open and debate them properly. This means when an idea does gain traction among some team members, if it has not been debated and buy-in gained, the team will ultimately not commit to the decision or action. This can have a knock-on effect of not having clear and agreed goals, which can lead to ambiguity and lack of focus.

Characteristic 4: Avoidance of accountability
When teams are not committed to the objective or goal, it is unlikely that the individuals within them will take full accountability for the team's actions. Even the most dedicated employee would find it difficult to hold others to account if they do not believe in the cause.

Characteristic 5: Inattention to results
If people aren't committed or held to account, personal agendas can start to distract the team and members' eyes are taken off the ball. This can lead to goals being missed and results not achieved, which, in turn, can affect commitment and motivation.

Overcoming barriers to high performance

So what can managers or team members do to move away from underachievement and change to a productive, high-performing team? There may be no 'I' in team, but there is a 'me'. Each team member has an important role in the success of a team and leaders need to be aware of the impact they themselves have on creating the right environment for all team members to:

- deal with trust issues;
- value conflict;
- encourage commitment;
- promote accountability; and
- celebrate results when the team achieves something.

The Apple team in the film *Steve Jobs*

REX FEATURES

Setting standards and benchmarking

By setting standards, a leader can perform their role in overcoming barriers to high performance. Clear performance standards start to tackle issues around trust, communication, commitment and results. Standards are important because:

- they give clarity of purpose;
- they shape the way things need to be done culturally;
- leaders can be explicit about the performance expected, leading to improved productivity;
- leaders can reward excellent performance, as once the standard is reached, a result can be recognised; and
- leaders can identify development needs helping self-awareness, confidence and stretch.

Standards can come from lots of different places and most leaders will be surrounded by them. Their organisations are usually a source of standards, which many will recognise in the shape of values/goals, KPIs and defined internal behaviours. Other places to look for standards are through competitors or industry benchmarks.

The ACT has developed its own benchmark competency framework, which defines the skills and competencies a treasurer needs no matter what stage of their career. Developed after extensive consultation within the profession, it sets the standards for not only the technical treasury skills needed, but also the business and behavioural skills, too.

In order to be a rounded leader within treasury, the ACT suggests that treasurers must be slick operators when it comes to influencing and working with others effectively. These skills, of course, are critical when applied to the need for leaders to drive the performance of their teams and overcome the barriers highlighted above.

To this end, learners on the ACT's Diploma in Treasury Management qualification, which leads to AMCT member status, are now required to complete a new unit called The Treasury Manager. This unit explores the leadership skills required from treasurers, covering topics such as leading a team, encouraging teamwork and collaboration, influencing, negotiation and conflict management skills. In short, all the soft skills needed to help drive a high-performing team.

The ACT also has an online diagnostic tool, which helps leaders to identify the strengths and development areas of their team, the Capability Analysis Tool. This checks more than 80 competencies from the ACT's competency framework and can offer managers a real insight into both themselves and their team's effectiveness.

Back to Apple

Looking for some of the signs of performance in your own team and striving to improve them can only help build success. With Apple's charismatic leader and team focus, business performance naturally followed. In Steve Jobs' own words: "Great things in business are never done by one person; they're done by a team of people."

The ACT suggests that treasurers must be slick operators

Vanessa Harwood-Whitcher is director of professional standards and learning at the ACT

SHUTTERSTOCK

POWERS OF CONCENTRATION

WEIGHING UP FINANCIAL COSTS AND BENEFITS CAN BE DAUNTING. DOUG WILLIAMSON SHARES A SIMPLE TOOL TO SORT OUT THE NUMBERS

As corporate treasurers, we can often improve interest income by switching temporary cash surpluses between different currencies, using an FX swap. This is an example of cash concentration. Given the obvious benefits, why don't treasurers do that all the time?

FX differences

An FX swap will produce FX differences, and potentially FX losses. These FX losses can wipe out any interest benefits.

Weighing up the costs and benefits can be tricky, but a simple 'With vs Without' technique will keep our thinking clear. We'll apply this technique to a practical case, derived from a recent exam question.

Dollar attractions

TSA, based in Paris, has a temporary cash surplus of EUR 8 million for 180 days. TSA has a US subsidiary, which has a surplus of USD 5 million, also for 180 days. Rates available locally to TSA and to its US subsidiary are set out below.

180-day deposits, per annum:
EUR: 0.05%
USD 5 million: 0.224%
Above USD 10 million: 0.24%
(banded basis)

FX swap rates:
USD/EUR 0.8000
180-day points: 6, deducted

Calculate which of the following is better for TSA:
- Concentrating the euro to the US using the FX swap
- Investing the euro in Paris

Ensure that the US subsidiary is left in the same position as if it had acted independently. Work to the nearest €k (thousand euro).

Certificate in International Cash Management, simplified extract

Trade-off

These interest rates are higher in dollars than in euro. So investing in dollars will clearly provide more interest income.

However, the different exchange rates for swapping currencies, and then swapping back again, work against us. This hits us with an offsetting FX loss.

It's useful to understand this trade-off, but we don't necessarily need to calculate the offsetting items separately.

Keep it simple

A simpler plan is to compare the net cash at maturity under each alternative.

This will show the net benefit, or the net loss, from undertaking the deal. We'll calculate the terminal cash in euros:
- With concentration in dollars using the FX swap, leaving the US subsidiary in the same position as if it had acted independently; and
- Without concentration, investing the euro locally in Paris.

Difference = benefit or loss

The difference between 'With' and 'Without' will be the net benefit, or the net loss.

With	**X**
- (Without)	**(X)**
= Benefit/(loss)	**X/(X)**

With concentration

The concentration in US dollars, with an FX swap, needs four steps:
(1) Swap €8m into dollars.
(2) Interest on the combined dollars deposit.
(3) US subsidiary's independent position.
(4) Swap back the balance of dollars into euro.

With concentration	$k	Steps
€8m swapped	10,000	(1)
+ Subsidiary's own funds	5,000	
= Combined $ deposit	15,000	
+ Interest added	18	(2)
= Maturing deposit	15,018	
(Retained by subsidiary)	(5,006)	(3)
$k to swap back	**10,012**	(4)

(1) Swap €8m into dollars
The near leg exchange rate is USD/EUR 0.8000. We're calculating *to* the base currency USD. So *divide* the variable currency €8,000k by this rate:
8,000k/0.8000
= **$10,000k**

(2) Interest on combined dollar deposit
$15,000k x 0.24% x 180/360
= **$18k**

(3) If US subsidiary had acted independently
Dollar interest income, to the nearest $k:
$5,000k x 0.224% x 180/360
= $6k

Independent cash at end:
$5,000k + $6k
= **$5,006k**

The US subsidiary must be left in the same final position as if it had acted independently. So this amount is retained in the US.

(4) Swap back into euro
Far leg exchange rate, USD/EUR, deducting the 180-day points of 6 (= 0.0006):
0.8000 – 0.0006
= 0.7994

We're calculating *from* the base currency USD. So *multiply* the base currency $10,012k by the far leg rate:
10,012 x 0.7994
= **€8,004k**

This is the cash in euro at maturity, 'With' the FX swap and concentration. Now we need to compare that result against the 'Without' independent alternative.

Without concentration, investing €8m in Paris

Euro interest income without an FX swap, instead investing directly in Paris:
€8,000k x 0.05% x 180/360
= €2k

Cash at end:
8,000 + 2
= **€8,002k**

Net benefit

	€k
With concentration	8,004
Without: independent	(8,002)
Benefit	**2**

TSA is better off by €2k, with the temporary concentration in US dollars. The dollar position of the US subsidiary is identical under both alternatives.

So it's beneficial to undertake the temporary concentration in dollars, on the basis of this comparison.

Other factors

In practice, we need to take account of a number of other important issues, including:
- Administrative time;
- Bank fees and charges;
- Any uncertainty in the cash-flow forecasts in each currency; and
- Counterparty risks.

These may change our decision.

Different rates

If the exchange rates were different, the net benefit of €2k we calculated previously might become greater, smaller or even a net loss. Try recalculating the results with 180-day points of 9 deducted, rather than 6. All other information remains the same.

What's changed?

Steps (1) to (3) are unchanged. The only difference is the re-exchange of dollars into euro, in our final step (4).

HELP FOR ACT STUDENTS

Download further useful study information from the student site you are assigned to: either the Resources area of the ACT Learning Academy at learning.treasurers.org or the Exam Tips area of the ACT Study Site at study.treasurers.org

The far leg exchange rate will become:
0.8000 – 0.0009
= 0.7991

The EUR proceeds from swapping back $10,012k are now:
10,012 x 0.7991
= **€8,001k**

Worse off

The overall comparison becomes:

	€k
With concentration	8,001
Without: independent	(8,002)
Loss	**(1)**

Now we're *worse off* with the temporary concentration, by €1k.

How did that happen?

The reason we're worse off is that FX loss has increased. The FX loss now exceeds the interest benefit, by €1k.

With these exchange rates, it would be loss-making to undertake the temporary cash concentration. So we wouldn't do it on the basis of these exchange rates. We should either decline the opportunity, or negotiate for better rates.

Doug Williamson is a treasury and finance coach

THE ZERO-SUM GAMES

The treasury world has been inspired by the 2016 Olympics and Paralympics. Start training now to compete in these exciting new games!

IKON IMAGES

The 110km regulatory hurdles

The traditional hurdles race is extended from 110m to 110km. The height of the hurdles varies, as does the spacing between them. Moreover, during the course of the race, hurdles are moved, repositioned, heightened, shortened and (very rarely) removed altogether, with little or no warning. Each hurdle has its own particular set of rules, which treasury athletes must read before attempting to leap over them. At the conclusion of the race, the whole thing starts all over again. The winner is the person who fires the starting pistol.

The treasury heptathlon

Treasury athletes compete in seven events to demonstrate their core competencies – (1) ability to gamble and call it 'risk management'; (2) ability to communicate passionately and convincingly, while ensuring that no one understands a single word; (3) trade execution (aka blaming the bank for costly dealing mistakes); (4) profit-centre management (aka taking credit for those rare dealing mistakes that actually make money); (5) systems implementation (treasury athletes who electrocute themselves or wipe out the entire server will be penalised 50 points); (7) numeracy skills.

Javelin catching

Treasurers know the feeling of the CFO chucking everything at them. In this event, treasury athletes have to catch as many finance javelins as possible. The winner is the one who isn't skewered.

Thinking outside the boxing

This event challenges treasury athletes to avoid the punches and blows that usually rain down on them when they try to do something a bit different. It comprises 12 rounds of 45-minute PowerPoint presentations. The winner is the one who stays awake and can remember more than two new ideas that were proposed.

Business cycling

The velodrome is the setting for this event in which treasury athletes go round and round in circles endlessly, eventually becoming totally confused as to whether they are ahead of the market or behind it. The race never ends; there are no winners.

Delegation dressage

Inspired by equestrian dressage where the horse does all the fancy footwork while the rider gets the medal. In this event, treasury athletes have to demonstrate their ability to delegate to adequately trained subordinates and then modestly share the glory while getting all the actual rewards. Points are lost if the competitor looks like they're doing anything remotely useful.

THE ASSET ALLOCATION MEDALS TABLE

The Rio Olympics gold medals were made up of 494 grams silver and 6 grams gold – worth around $300 and $255 respectively, so $555 in total. The silver medals are mostly silver with a bit of copper, and are worth around $290. And the bronze medals? Mostly copper, worth $3 on a good day.

Athletically minded treasury professionals might well conduct a cost/benefit (effort/reward) analysis and conclude, therefore, that a silver medal is the optimal prize – the marginal effort of going for gold simply not being worth it.

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