The Treasurer
September 2015
The Magazine of The Association of Corporate Treasurers

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The latest on cash and liquidity management

BE A VALUES-LED LEADER
Advice on how you can set the right tone at the top

The Treasurer

THE MAGAZINE OF THE ASSOCIATION OF CORPORATE TREASURERS ◆ SEPTEMBER 2015

Surviving the slump

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EDITOR'S LETTER

They say that all good things must come to an end. And for me, the end of an era has come because this is the last time that I will be addressing you as editor of *The Treasurer*.

After three highly rewarding years, during which I have really enjoyed working with both the ACT and the broader treasury community, I am stepping down in order to focus on starting my own business. I will continue to follow treasury matters with keen interest, however, and I hope that I will still cross paths with lots of treasurers in the future.

Just like the many people that I have interviewed, who have told me that they "fell into treasury, but ended up loving it", I have had exactly the same experience and I know that the word 'treasury' will probably give me a warm glow in my heart for many years to come.

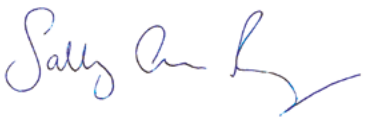
Fortunately, though, I am leaving in you in very capable hands, because my successor is Liz Loxton, an experienced finance writer and editor, who earned her journalistic spurs working on well-known finance titles such as *Accountancy Age* and *Insurance Week*. You can find out more about her on page 7.

Turning to this month's issue, I am delighted that we are running a profile interview with Ian Chisholm, vice president financial markets at Shell (see page 22). He gives us a fascinating insight into what it is like to work in the treasury function of one of the world's biggest oil companies, and how treasury helps to influence business strategy.

We also take a look at just what the ACT has been doing to help improve professional standards within the financial sector over the past few years, on page 18. You will be proud to see that your association has been very active in a number of areas, including the Hogg Committee that was set up to recommend a new administrator for Libor, the Fair and Effective Markets Review, and the Lambert report that established the Banking Standards Board.

Keeping with the topic of standards, we examine what it takes to be a values-led leader in our career feature, starting on page 56. I hope that it offers you some useful pointers as you evolve your own leadership style.

Finally, I would like to wish you the very best for the future in all your endeavours. I firmly believe that the world is a better place with treasurers – and the ACT – in it.



editor@treasurers.org
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THIS MONTH'S CONTRIBUTORS

Odette Izquierdo is head of liquidity management, Latin America, at Citi. Based in Mexico, she is well placed to comment on the challenges of operating in Latin America and the strategies that companies can use to help them to reduce risk and make optimal use of their cash in this unpredictable region. Find out what she has to say, on **page 42**

Jessica Walker is a senior associate in the restructuring, bankruptcy and insolvency practice of law firm Mayer Brown. She has considerable experience of advising on all elements of domestic and cross-border restructuring and insolvency matters. She examines the latest trends in the world of restructuring and what these mean for treasurers, on **page 54**

Jo Simpson is an executive leadership coach and keynote speaker, who specialises in values-based leadership. Her new book, *The Restless Executive*, helps leaders to overcome feelings of unrest and frustration so that they can lead with purpose. She offers her advice on how treasury professionals can become values-led leaders, on **page 56**

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CASH & LIQUIDITY MANAGEMENT
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SKILL SET

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BEHAVIOURAL SKILLS

BUSINESS SKILLS

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

{ CONTEXT OF TREASURY }

DIGITAL STRATEGY BOOSTS CONFIDENCE OF UK CFOs

The digitisation of finance functions is helping UK CFOs to feel more confident about the future than their European counterparts.

According to research by recruiter Robert Half, 89% of UK finance leaders believe that their finance functions are in a strong position to address business challenges. This compares with 83% of their peers in continental Europe.

Yet while UK businesses can use their digitised finance functions to remain compliant and competitive, some 87% of CFOs said they faced challenges in the roll-out of their digitisation plans.

Overall, 40% of finance leaders pointed to technology limitations as the biggest barrier to successfully digitising the finance function. Organisational and operating models were the second most common hurdle that needed to be overcome.

As businesses look to identify growth opportunities, they are relying more on access to big data. Half (50%) of UK businesses are looking to invest in data analytics as an extension of their digitisation plans for the finance function.

Fraud detection (43%), and compliance and regulation (35%) followed as areas identified to receive investment. A lower proportion of finance leaders (21%) said that they would invest in financial reporting as part of the digitisation agenda, while just 7% said that they would not make any investments at all in new areas or initiatives.

{ QUESTIONS YOUR FD IS LIKELY TO ASK THIS MONTH }

CHINA

What is going on in China?

China has been the darling of the world economy for more than three decades, notching up an average of 10% growth a year until the recent slowdown. If Chinese official figures are to be believed, its GDP is still set to expand by 7% this year, an achievement that more developed markets can only dream of. Nevertheless, the Chinese government's shock decision to devalue the renminbi in the middle of August indicates a flagging economy. Inflation only rose by 1.6% in July – half the target of 3% – while exports tumbled by 8.3%, far worse than expected.

What does this slowdown mean for commodity producers?

As China is the world's second-largest economy and its largest consumer of commodities, you can pretty much say that when China sneezes, commodity

producers catch a cold. Global stocks tumbled, with mining companies badly hit due to anticipation that China will have less demand for metal imports, such as copper. Meanwhile, the oil price also fell, as did the share prices of car makers and luxury goods businesses, which were affected by concerns that a weaker renminbi would make their goods more expensive to consumers in China, thereby damaging their competitiveness.

What's this I hear about a global currency war?

In truth, it feels like there has been a global currency war raging ever since the global financial crisis struck, with China just the latest nation to join the fray. Following the devaluation of the renminbi, the US dollar promptly strengthened against the Chinese currency, as well as against the Australian and New Zealand dollars. So the volatility that has marked the currency markets over the past few years looks set to continue.

What about the Chinese stock market? I heard something about a crash.

Yes, the Shanghai Composite Index hit a seven-year high in June, but by 8 July it had lost 32% of its value. Beijing authorities blamed 'illegal short sellers' for fuelling the stock slide. Although the Chinese government has not publicly linked the crash to its decision to devalue the renminbi, timing suggests that the crash had a part to play.

SHUTTERSTOCK

"I've been around for a long time, and it just seems that the economy does better under the Democrats than the Republicans."

These words, uttered in a 2004 interview, came back to haunt presidential candidate Donald Trump (pictured) last month as the race for the Republican party's nomination heated up.

"China's rapid U-turn in monetary policy highlights that the nation's economic situation is reaching desperation point."

The decision of the world's second-largest economy to devalue its currency is ominous, observes Philippe Gelis, CEO and co-founder of business FX marketplace Kantox.

SOURCE: KANTOX, 11 AUGUST 2015

{ HIGHLIGHTS OF RESEARCH BY TUNGSTEN CORPORATION INTO LATE PAYMENTS }

22%
of SMEs say that most of their late payments come from large businesses

32%
of tech businesses have been impacted by late payments

£40,857
is the amount that the average SME is owed in unpaid invoices

£212bn
could be the amount in unpaid invoices owed to the UK's 5.2 million SMEs

23%
of UK SMEs have been at risk of closure due to late payments

{ CONTEXT OF TREASURY }

A QUARTER OF UK SMEs COULD CLOSE DUE TO LATE PAYMENTS

Late payment of invoices is threatening the survival of nearly a quarter of all SMEs, according to new research.

The average SME is owed £40,857 in unpaid invoices, a survey by e-invoicing company Tungsten Corporation revealed, with £20,937 of that total overdue.

When applied across the UK's 5.2 million SMEs, the total owed could be as much as £212bn.

Of the 1,000 companies surveyed by Tungsten, 23% responded that late payments have put them at risk of closure. The issue was most acute in the technology sector, where almost a third of all businesses (32%) had been impacted financially by late payments from customers.

The survey results suggest that the issue spans customer sizes and types, with 22% of those surveyed saying most of their late payments were from large businesses, 11% pointing to medium-sized firms and 8% citing the public sector as being responsible for late payments. A third (33%) of businesses surveyed said that there was no clear pattern.

Richard Hurwitz, CEO at Tungsten, said: "These figures are a telling reminder of the challenges faced by SMEs in this country. An unpaid invoice can mean the difference between a successful month of trading and a dangerous financial shortfall. In the worst case, it could lead to insolvency."

For more on late payments, see page 38

What do you say?
Tweet us
@thetreasurermag

"Ask anyone who knows anything about Greece's finances and they will tell you this deal is not going to work."

If you're confident that the latest Greek bailout deal will put an end to the country's ongoing debt saga, you're probably kidding yourself, according to former Greek finance minister Yanis Varoufakis (pictured).

VERVERIDIS VASILIS/SHUTTERSTOCK.COM

{ CONTEXT OF TREASURY }

The Treasurer gets a new editor

Experienced journalist and editor Liz Loxton is taking over as editor of *The Treasurer* from the October 2015 issue. She succeeds Sally Percy, who has left to start her own financial content agency.

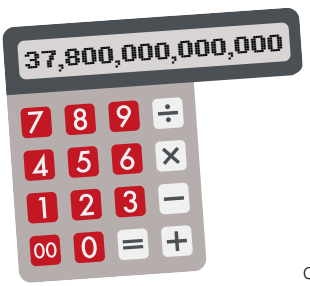
Loxton has more than 20 years' experience in publishing, and honed her writing and editorial skills on business and finance titles such as *Accountancy Age*, *Insurance Week* and *Post Magazine*.

She has written across a range of business issues, including financial management, fraud, human capital, insurance, leadership and risk. She edited *Hourglass*, a client publication for PwC Consulting, for three years.

9%
the amount that could be wiped off Russia's GDP as a result of sanctions, as predicted by the International Monetary Fund

23%
the increase in credit applications from SMEs that were rejected by banks in the first quarter of 2015, compared with the same period last year, as estimated by alternative lender Fleximize

€37.8 trillion
the sum total of investment fund assets worldwide in March 2015, as revealed by the European Fund and Asset Management Association



962,900
the number of jobs in the US that are supported by investment from UK businesses, says the Confederation of British Industry

$9.2bn
the amount that US financial software company Fidelity National Information Services paid for treasury management system provider SunGard

£65bn
the combined pension deficit of the FTSE 350 companies, up £11bn on the previous year, according to pension consultancy Barnett Waddingham

Paul Coyle
Having pleaded guilty to, and been sentenced to prison for, a charge of two counts of insider dealing brought by the Financial Conduct Authority, Paul Coyle, a former associate member of the ACT, has been found by a Disciplinary Committee to be in breach of the ACT Ethical Code. On its recommendation, in accordance with the Disciplinary Rules, the ACT's Council has resolved that Mr Coyle be excluded from membership.

{ KEY FINDINGS OF THE REVAL *FUTURE-PROOF YOUR TREASURY* GLOBAL SURVEY }

91% of treasury professionals think that current advancements in technology enable change in treasury

51% of treasury professionals are currently implementing or planning to implement new treasury technology

54% of treasury professionals say that improving cash flow forecasting is a key initiative for them

38% are focused on optimising payment management

35% say that technology should facilitate the centralisation of financial data

{ AROUND THE WORLD IN 30 DAYS }

GREECE POSTS 0.8% GROWTH IN Q2

Greece provoked widespread astonishment in August with the revelation that its economy had apparently grown by 0.8% in the second quarter of 2015. Figures released by the country's official statistics agency, Elstat, implied that Greece's ongoing debt crisis did not have a detrimental effect on its economy. Furthermore, revised data showed that the Greek economy neither shrunk nor grew in the first quarter of the year – previously the economy had been reported to have contracted by 0.2%. Nevertheless, the agency has also warned that the figures could be revised when more data becomes available.


Despite Greece's debt crisis, its economy has shown signs of growth

GETTY/ARIS MESSINIS/STAFF

Brazil's credit is downgraded

Brazil's investment-grade credit rating is hanging in the balance after rating agency Moody's cut its rating to near-junk status in August. The move followed rival rating agency Standard & Poor's (S&P's) decision last year to downgrade the country's long-term debt rating to BBB minus, its lowest investment-grade rating. S&P has since warned that Brazil could lose its investment-grade rating altogether if an ongoing corruption probe continues to weigh on the government's efforts to restore growth. Brazil is currently experiencing its deepest recession in a quarter of a century.

Mexican optimism dips

Mexico has lowered its growth forecast for 2015 to between 1.7% and 2.5% after its economy and national budget were hit by the oil price slump. Previously it had predicted GDP expansion of between 2% and 3%. Agustín Carstens, the chief of Mexico's central bank, said last month that conditions point to "a low index of growth in economic activity". He warned that the Mexican government was ready to raise interest rates in order to boost its currency, the peso, which has slumped badly against the US dollar over the past year.


Industrial and Commercial Bank of China has $3.5 trillion in assets

PAUL MCKINNON/SHUTTERSTOCK.COM

{ CONTEXT OF TREASURY }

CHINA HOUSES FOUR OF THE FIVE BIGGEST BANKS

China now boasts four out of the five largest banks in the world, in a ranking of banks by assets, undertaken by SNL Financial.

According to latest annual list compiled by the financial information provider, London-based HSBC is the only non-Chinese bank in the top five after weakening currencies led Paris-based BNP Paribas to slip to seventh place from fourth in 2014 and Tokyo-based Mitsubishi UFJ Financial Group to fall to eighth place from fifth.

Even HSBC itself slipped from second place in 2014 to fourth place this year. According to the report, it has $2.7 trillion in assets.

The largest bank in the world continues to be Beijing-based Industrial and Commercial Bank of China Ltd, with assets calculated at $3.5 trillion. The third-largest bank is Agricultural Bank of China Ltd, also based in Beijing, which shot up from seventh place in 2014. Meanwhile, the fifth-largest bank is Bank of China, which rose from eighth place last year.

New York-headquartered JPMorgan Chase, which is the largest US-based bank, remains the sixth-largest bank. Yet it would rank first if it followed the same accounting principles as the Chinese banks, SNL's analysis shows.

While US banks report using US GAAP, the biggest Chinese banks report under the IFRS. The difference is that under US GAAP, banks report the net amount of derivative assets on their balance sheets, while under IFRS, companies must report the gross amount of derivative assets.

Sixteen of the top 100 banks in the world are based in China, while 11 are US-based. Europe, including Russia, houses 43 of the top 100 banks.

The 2014 Deals of the Year Award winners with ACT CEO Colin Tyler

ARE YOU A WINNER-IN-WAITING?

When it comes to your career, few things can beat the buzz of being recognised with an industry award. Not only is an award a very public acknowledgement of what you have achieved, it can also open up new opportunities, as well as be a welcome boost to your CV.

That's why you and your treasury team should think about entering *The Treasurer*'s Deals of the Year Awards, which exist to recognise the achievements of the most talented people in the profession and to showcase their accomplishments to the wider business world.

We are looking to reward best practice from right across the treasury spectrum, whether that's financing a major acquisition, restructuring a debt arrangement, issuing a benchmark-size bond for the first time, setting up a supply chain finance scheme, or pulling off any other treasury-related feat. If you've done something impressive, we want to hear about it.

Nominations for *The Treasurer*'s 18th annual Deals of the Year Awards open on 15 September and close at 4pm on 6 November. They are open for treasury deals and treasury teams from across Europe. You can find out more by watching our videos (prepared for the awards dinner last year) or by listening to the short or long version of our podcast, both of which can be found at www.treasurers.org/awards/2015. For the first time this year, the awards entry process will be conducted entirely via an online awards platform.

Treasurers, as well as their banks and advisers, are encouraged to nominate as many deals as they wish.

We will make awards in the following categories:

- **Bonds with a currency value above £500m or equivalent** (including all high-yield bonds, private placements and multi-currency tranches);
- **Bonds with a currency value below £500m or equivalent** (including all high-yield bonds, private placements and multi-currency tranches);
- **Corporate finance** – strategic (hybrids, initial public offerings, convertibles and M&A-related transactions) and business finance (trade financing and supply chain finance);
- **Loans above £750m** (or equivalent currency value);
- **Loans below £750m** (or equivalent currency value);
- **Overall Deals winner** (selected from the winners of the above categories);
- **UK Treasury Team of the Year** (for companies with a market capitalisation above £2bn);
- **UK Medium-Sized Business (MSB) Treasury Team of the Year** (for companies with a market capitalisation below £2bn); and
- **EU Treasury Team of the Year** (no market capitalisation limit).

In previous years, we have reviewed deals from countries including Finland, France, Germany, Ireland, Italy, Poland, Spain and the UK, with deal sizes varying from $25m to $45bn. In each category, we consider all types of deal, whatever their size or complexity, and judge them according to our criteria of sound treasury management, efficient pricing, optimal and innovative structures and relative success in the prevailing market conditions. The team awards recognise treasury teams' considerable and enduring contribution to their companies.

Winners will be announced at the Deals of the Year Awards dinner in early February 2016 and their feats will be written up in the February 2016 issue of *The Treasurer*. You will also be able to find out about the award winners online at www.treasurers.org/awards

Lloyds Bank is proud to continue its support of *The Treasurer*'s **DEALS OF THE YEAR**

LLOYDS BANK

2014 CHAMPIONS

Here's a reminder of the achievements of the 2014 Deals of the Year winners:

Overall winner and winner of the corporate finance category: Sky
The treasury team of media giant Sky secured a £6.6bn + €4bn funding package to finance two big complex acquisitions within a tight timescale.

Bonds above £500m: Ryanair
Irish airline Ryanair issued its first-ever senior unsecured bond in June 2014, taking advantage of low bond yields to raise €850m through seven-year notes.

Bonds below £500m: E.ON
German utility company E.ON achieved a negative yield to maturity of -0.248% with its €113m exchangeable bond.

Loans above £750m: Merck KGaA
German pharmaceutical company Merck arranged the largest corporate acquisition financing in Europe since the financial crisis, with its $15.6bn dual-currency loan.

Loans below £750m: J Sainsbury
British supermarket J Sainsbury made history when it arranged the first green corporate loan – a five-year loan for £200m.

UK Treasury Team of the Year (market capitalisation above £2bn): Royal Mail
Royal Mail's treasury team tapped the markets for the first time just nine months after the company was privatised.

UK Treasury Team of the Year (market capitalisation below £2bn): Phoenix Group
The treasury team of Phoenix Group restructured the balance sheet of the UK's largest consolidator of closed life and pension funds.

European Treasury Team of the Year: Deutsche Annington
The treasury team of German residential landlord Deutsche Annington juggled various projects, including a €2.4bn strategic growth financing (to modernise 11,000 residential units) and the launch of four benchmark bonds, as well as two hybrid bonds.

WORKS IN PROGRESS?

As in July/August, many of our topics here remain works in progress. At the time of writing, Grexit appears dead as funding for Greek banks is being negotiated to enable the local economy to resume activity. The ACT has responded to the EU on the European Market Infrastructure Regulation to call for single-sided reporting to trade repositories. Meanwhile, HM Treasury has called for input on card interchange fees, the CHAPS day is lengthening and lease accounting rules will change.

Stephen Baseby is ACT associate policy and technical director @BasebyStephen

{ IN DEPTH }

ACT COMMENTS ON TRADE REPOSITORY REPORTING

The ACT has lodged a response to the EU consultation document on the European Market Infrastructure Regulation (EMIR). In our response, we have argued for a single-sided reporting (SSR) obligation and for conformation of the collateralisation obligations of the EU with those of the US. This is because the current difference reduces the competitiveness of EU-based commodities businesses relative to those of the US. To see our response, visit www.treasurers.org/ACTmedia/EMIR_Consulation_Response_August_2015.pdf. To see the consultation document, visit http://tinyurl.com/p2jurkm

As discussed in our last Technical Briefing (see *The Treasurer*, July/August 2015, page 10), there is recognition that the transaction-reporting process has not produced data of a quality appropriate to its purpose and that SSR may provide cleaner data, which regulators can use more fruitfully. We are also seeking the removal of the obligation for non-financial counterparties to report on their trades.

Meanwhile, the EU has readdressed the repo market through the Securities Financing Transactions (SFT) Regulation as part of a broader concern to understand the scope and depth of the markets in which securities are traded as collateral. Its concern is that the reliance on collateralisation to mitigate market risk would require pools of collateral to be available in order to be borrowed and lodged.

The outcome has been to place an obligation on SFT market participants to report their transactions to a trade repository. Only SMEs would be exempted and so those corporates that use the repo market to enhance their yields and counterparty diversification will need either to arrange to report their transactions into a trade repository or delegate the action, but not their obligation.

YOUR SHOUT

If you have views on what you would like the ACT policy and technical team to take into account when responding to any of the subjects on these pages, or if you have your own submission that you are willing to share on these or other consultations, please email us at technical@treasurers.org

The Bank of England has announced an extension to the CHAPS and CREST settlement business day

{ WATCH THIS SPACE }

SETTLEMENT DAY IS EXTENDED

The Real Time Gross Settlement infrastructure is the system through which the Bank of England fulfils its role as settlement agent for the main sterling payment systems. It does this by enabling direct participants in these systems (the CHAPS and CREST settlement banks) to settle their interbank obligations in central bank money. This includes banks making payments on behalf of corporate clients.

The Bank of England has announced that, from summer 2016, the CHAPS and CREST settlement day will be extended to align more closely with the business day. This should result in greater flexibility for end users, given the greater time zone overlap with other important financial centres, and the opportunity to make high-value transactions later in the business day.

The ACT is already working with the Bank of England and the service providers to ensure that the potential benefit is passed on to end users, but we would like to hear from you if you have any specific concerns about how this may impact your ways of working going forward. Please contact Sarah Boyce at sboyce@treasurers.org

For further information, visit www.bankofengland.co.uk/publications/Pages/news/2015/059.aspx

{ TECHNICAL ROUND-UP }

FOCUS ON FEES

Multilateral Interchange Fees for card payments (MIF Regulation (EU) 2015/751) entered into force on 8 June, with application from 9 December 2015. The ACT has responded to HM Treasury and the Payment Systems Regulator on the implementation of these new rules on the interchange fees element of credit and debit card transaction charges. See www.treasurers.org/ACTmedia and http://tinyurl.com/oax9tgp

Imposition of the new interchange charges may impact on those corporates that accept debit cards for transaction values in excess of £25 because these will have *ad valorem* interchange fees, whereas they have previously been a flat charge for many corporates, thereby reducing the long-standing advantage of debit cards over credit cards.

Regulation of benchmark users' fees has followed on from the Fair and Effective Markets Review. The Financial Conduct Authority has recently published a consultation paper on 'fair, reasonable and non-discriminatory access' to regulated benchmarks. The paper sets out proposals for benchmark administrators to charge users fees and licences, noting that different fees can be charged to different users only where this is objectively justified.

The ACT has responded to note that corporates do not use benchmarks for trading, but typically to agree periodic settlements and therefore object to onerous fees and the administrative processes foreseen by the review. See www.treasurers.org/FRAND-response-August2015

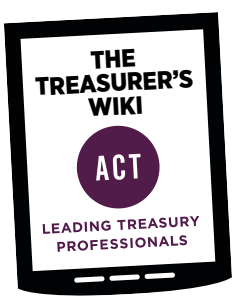
View the following technical updates and policy submissions at www.treasurers.org/technical and www.treasurers.org/events/webinars

USA Foreign Bank Account Reports regulation – for an update on changes to this reporting obligation on US businesses, including those owned by parties outside of the US, see http://tinyurl.com/pd9zf2v

UK Financial Reporting Council responds to European Commission's Recommendation on the quality of corporate governance reporting. See http://tinyurl.com/qxztdrw

EACT report on regulatory issues 1 July 2015, including an update on the financial transaction tax, money market funds and bank ring-fencing. See www.treasurers.org/node/9894

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



MATT KENYON/IKON IMAGES

{ INTERNATIONAL }

IASB PRESSES AHEAD WITH LEASE ACCOUNTING

The International Accounting Standards Board (IASB) has completed its re-deliberations regarding the new accounting standard on leases, which is expected to be issued before the end of 2015.

This new accounting standard will require lessees to recognise assets and liabilities for all identified leases, whereas IAS 17, *Leases*, only required assets and liabilities for finance leases to be recognised on the balance sheet.

For many companies, this will result in a grossing-up of the balance sheet, potentially impacting financial covenant ratios that include 'debt', 'net financial position' or similar indicators. EBITDA is also likely to increase and the interest cover ratio could potentially decrease because of the reclassification of the current operating lease expense.

Under the new standard, lease expense is split into two, with interest on lease liabilities classified as finance (interest) cost, and amortisation of lease assets as depreciation of property plant and equipment (generally in operating expenses).

Of course, financial covenants based on 'Frozen GAAP' (ie accounting standards effective at the date of the loan agreement) will not be directly affected.

The European Financial Reporting Advisory Group and the IASB, together with the National Standard Setters of France, Germany, Italy, Lithuania and the UK, are carrying out a public survey to understand the extent to which financial covenants are based on figures reported in accordance with IFRS.

Treasurers are encouraged to complete questions 1 and 10 of the survey, which closes on 30 September 2015. See http://tinyurl.com/oj87jlv

The IASB will issue a feedback statement in order to share the results of the public survey.

60-SECOND INTERVIEW

FRANÇOIS MASQUELIER

HEAD OF TREASURY, CORPORATE FINANCE AND ENTERPRISE RISK MANAGEMENT, RTL GROUP

How did you get into treasury?
Having worked for a couple of years in a bank, I got an opportunity to join a treasury centre in Brussels, and then discovered corporate treasury.

What do you like about treasury?
I like the diversity of tasks and roles. Treasury keeps evolving and accelerating, especially after the global financial crisis in 2008. I like the technical aspects, the hyper-specialisation and the sophistication of treasury activities – also the very central role that we play with all company stakeholders.

What benefit do you get from being a member of the ACT's LinkedIn group?
It gives me excellent and direct contact to peers, and is a fantastic tool for staying informed. It's a really efficient forum to share experiences and expertise with fellow treasurers.

Are you involved in any other treasury associations? If so, which ones and how?
I am a member – and chairman – of ATEL, the Luxembourg treasury association. ATEL is also a member of the European Association of Corporate Treasurers, of which I am vice chairman.

What do you think are the most pressing challenges facing the global treasury profession?
The disruption created by many changes, new financial regulations, market volatility and new IT technology. Managing all these changes, and adapting the function to the moving environment and to business constraints or cost cutting, while delivering good-quality treasury services, remains a huge challenge for all of us.

What are the most exciting opportunities facing the treasury profession and why?
The challenging environment makes the job exciting. Changes always imply opportunities to revisit processes, to revamp the organisation and to enhance internal controls. Being compliant, and delivering better and more with limited resources, forces treasurers to be inventive, innovative and somewhat creative.

What's the greatest piece of career advice that you have ever been given?
Never neglect your network; and find a mentor, who will give you support in managing your career.

If you weren't a corporate treasurer, what would you be?
I would have loved to be an architect.

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

ACT TRAINING

16-17 September, London
Treasury systems
Learn how to successfully deliver a project to identify and select the technological needs of the treasury department and to implement that chosen technology.

6 October, London
Working capital optimisation
Get an overview of why working capital management is vital for the profitability and survival of all companies. You will also gain an appreciation of the techniques that can be employed to manage working capital, and improve profitability and cash flow.

7-8 October, London
Investing corporate cash
Find out which factors should be taken into account when investing corporate cash, including counterparty risk, liquidity and yield, and a review of policy, process and controls.

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 PC-based course will teach you the concepts for evaluating the different types of interest rate risk, with hands-on modelling experience.

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

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

ACT EVENTS

15 September, London
ACT Working Capital Conference
Making capital work
Recent research indicates that inefficient working capital management results in over €1.5 trillion locked up in excess working capital globally – around €762bn of it in Europe. Discover how to take a more strategic approach to working capital management, optimise business processes and unlock the cash tied up in your supply chain. You can also explore the metrics used to monitor working capital management performance.
www.treasurers.org/workingcapital

28 October, London
ACT Corporate Funding Conference
Capital gains
This one-day conference will be packed full of corporate case studies, panel discussions and round tables on how to manage your funding requirements in an uncertain market, and provide you with insight into all aspects of corporate funding.

Whether you're interested in the bigger picture and what this might mean for you and your business, revisiting traditional methods of funding or finding out more about alternative sources you might be considering but haven't tapped, then this conference is the place to be.
www.treasurers.org/corporatefunding

11 November, London
ACT Annual Dinner
Taking place in the sumptuous surroundings of the Grosvenor House Hotel's Great Room, the Annual Dinner is a unique opportunity to network with your peers, while enjoying a three-course meal and fine wine in one of the most prestigious venues in London.
www.treasurers.org/annualdinner

23-24 November, Dubai
ACT Middle East Annual Conference 2015
Strategy, agility, prosperity
The ACT Middle East Annual Conference is the pre-eminent corporate treasury conference and networking event for the Gulf Cooperation Council region.
www.treasurers.org/actmiddleeast/annualconference

To attend an ACT event, book online at www.treasurers.org/events. For more information, email events@treasurers.org or call +44 (0)20 7847 2589

ACT WEBINARS

Join in the discussion and debate from the comfort of your desk
Led by the ACT's policy and technical experts, ACT webinars give direction on regulatory change and key treasury concerns direct to you, wherever you are in the world.

For details of our 2015 webinar programme, visit www.treasurers.org/webinars

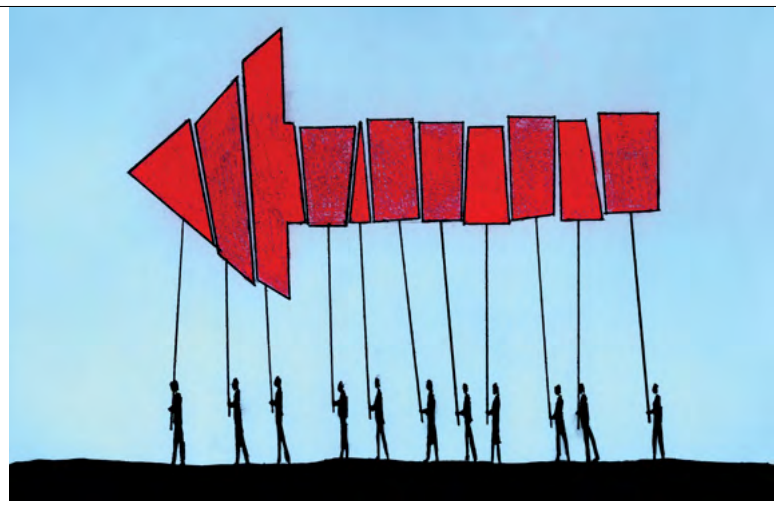
To attend an ACT webinar, book online at www.treasurers.org/events. For more information, email events@treasurers.org or call +44 (0)20 7847 2589

{ QUALIFICATIONS AND EVENTS }

COLIN TYLER

Even the summer slowdown doesn't stop the ACT from forging ahead

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



IKON IMAGES/GARY WATERS

As late as mid-July, the memo about the hoped-for 'summer slowdown' didn't seem to have been received – anywhere in the world. There was a crash – or at least a lot of froth being blown away – in the Chinese equity markets; a 'will-they-won't-they?' Grexit (and I talk less about the reality, more about the impact of uncertainty); some glimpses of central banks preparing for rate rises; and no let-up in the regulatory bun fight. These all weighed heavily on the holiday plans of many across the business and political spectrum.

The ACT has spent the summer working very hard across a number of fronts to address these and many other issues for treasurers and the real economy.

We have put the finishing touches to our revamped education process. Due to their strong focus on employability and practical skills that you can immediately apply in the workplace, ACT qualifications (and training) are a win-win for employees and employers alike. Learning is coupled with excellent tutor support and valuable industry networking opportunities to complement the practical skills that you, and your teams and colleagues, will learn.

We have revised our syllabi against the new ACT Competency Framework (www.treasurers.org/competencyframework), which is the result of consultation with senior treasurers from multinational corporations, banks, and learning and development teams worldwide. Mapping our qualifications against the skills and competencies of the framework means that we will continue to have the most up-to-date and relevant qualifications for real-world treasury practice.

Each qualification has been mapped to the four treasury job levels of the competency framework: tactical, operational, managerial and strategic. The new structure means that the ACT offers a progressive learning path for those choosing a career in treasury. Qualifying with the ACT will ensure that you have exactly the right skills and knowledge demanded by employers today.

Take a look – I promise you that it will be well worth your time and more.

There has been no relenting in our work on policy submissions or consultations, technical updates or interaction across the EU with regulators and legislators. We think that this detailed and often unsung work is critical to the development of any profession and completes what I would see as the full picture of ACT activity: education, qualifications and training; membership and professional development; and, lastly, a necessary commercial approach to provide more 'grease for our wheels'.

Even our events programme has barely taken a pause because we ran webinars well into the middle of July. We took a brief break and will be running them again from early September. We have been particularly pleased to have ventured into video webinars this year and these have been very well received. (The ACT's chief executive hasn't yet made a live appearance, which, for some, is a blessing.) Don't forget, too, that the back catalogue of webinars is a fabulous resource of expert comment and practical treasurer experience as well. Keep your ears and eyes on www.treasurers.org/events/webinars as we go into autumn.

The ACT is also taking steps to broaden our international exposure in both Hong Kong and China. Our ACT Asia Conference on 2 September will have come and gone by the time you read this, but it will play its part in the launch of our qualifications in China during the autumn. For the first time, the ACT's qualifications will be marketed in Mandarin Chinese.

This is a huge step forward for the ACT and it is significant not just for aspiring Chinese treasurers and finance professionals in domestic organisations, but also for non-Chinese companies that want to skill up their national workforces. To say that we're excited might not be the British way, but believe me, we are. Watch out for the launch!

I look forward to meeting as many of you as possible at the ACT events we have in our autumn calendar.

The ACT has spent the summer working to address many issues for treasurers

What are your thoughts on the September issue of *The Treasurer*? Email me at ctyler@treasurers.org or tweet @ColinTyl

{ EQUITIES }

JEREMY WARNER

Investors are buying up pharmaceuticals as they scramble for 'growth' stocks

Two big trends have dominated leading stock markets so far this year. One is the continued sell-off in commodity stocks (particularly mining and oil) sectors that have been slashing investment spending and warning about the outlook for profits as commodity prices tumble. The other is a kind of mirror image of what's happening to these industries – a scramble for supposed 'growth' stocks.

If it is true that the world economy has entered a period of 'secular stagnation', where, for most companies, top-line growth is increasingly hard to come by, then anything with growth potential becomes desirable, while traditional value stocks lose their allure. Pharmaceuticals, biotech and technology find themselves in high demand, driven by a combination of new product launches and, in the case of pharma and biotech, a renewed burst of consolidation.

This year has seen record levels of M&A in these industries, with bidders forced to pay big multiples of what they could have acquired the assets for only a few years back.

Remember the so-called 'super-cycle'. Mining and oil have historically always been a story of boom and bust. When demand and prices are high, they invest heavily, eventually leading to an excess in supply, falling prices and an investment winter.

Only, this time was supposed to be different. Rapid industrialisation in China and beyond, it was thought, would support demand for much longer than is seen in a more normal cycle. These 'super-cycles' have happened before, during European and American industrialisation, and more recently during European and Japanese post-war reconstruction.

But if you look at the very long-term charts for real commodity prices, they are relentlessly down, driven lower by new sources of supply and more efficient forms of extraction. 'Peak oilers' have long believed that the cheap and easily extracted stuff is now largely used up, or soon will be. Well, if it is, it is not reflected in prices, which, across the commodities spectrum, are a pale shadow of where they were little more than a year ago. Slowing Chinese growth has dashed hopes of an early rebound.

What's more, the make-up of Chinese economic advancement is changing. It's becoming less focused on investment, and more on consumption, and therefore, less commodity-intensive. It may well be that levels of Chinese infrastructure investment have already passed their high water mark.

Personally, I'm not a big fan of the idea of 'secular stagnation' – the theory that the period of enormous economic progress that characterised the past 200 years is now largely over, at least for advanced economies. Nonetheless, economic pessimism is proving a powerful force in investment, where risk aversion and consequent relatively low levels of real economy investment remain the order of the day.

Pharmaceuticals, biotech and technology are the three big standouts from this 'safety first' investment mindset. That's because all three sectors promise that increasingly scarce phenomenon – growth.

After a long period of relative famine, when pharmaceuticals R&D failed to build on the breakthroughs of the past, we seem to be on the verge of a whole raft of new blockbuster treatments.

Advances in technology have meanwhile given birth to an entirely new industry, the so-called 'shared economy'. This is extremely bad for traditional incumbents, which find old means of operating undermined by digital communications, but hugely lucrative for the pioneers in these new forms of distribution and consumption.

Even so, most 'growth' sectors are beginning to display 'bubble'-like characteristics. Just as oil and commodities may be starting to look a little oversold, it could be that the growth stocks have become somewhat overbought.

Pharmaceuticals and biotech find themselves in high demand

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

{ TREASURY INSIDER }

Divvying up the pot

There's a knack to satisfying bankers who are hungry for ancillary business, maintains our Treasury Insider

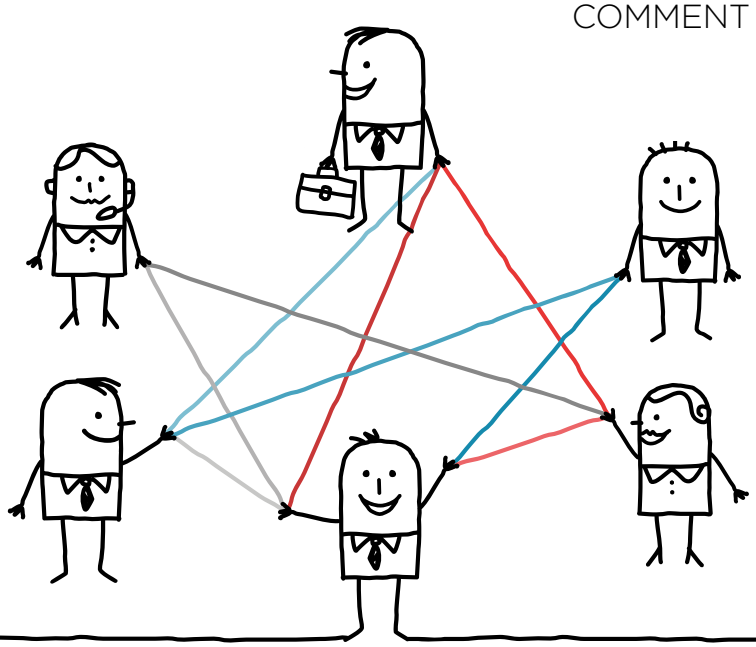


ILLUSTRATION: SHUTTERSTOCK

How do you make a banker happy? This isn't the start of a great joke – sorry to disappoint – but it underpins a constant consideration for treasurers. That is, ensuring that banks get sufficient ancillary business to justify their lending commitments. This is of particular interest to me, having just refinanced my organisation's revolving credit facility (RCF).

We've welcomed a number of new banks into our bank group – some new relationships, others providing lending commitments to secure continued ancillary business that they may otherwise lose. And within our ongoing relationships, some banks have increased their participation. Fantastic for the business, but we have many understandably hungry mouths to feed.

And that hunger has been heightened by Basel III's increased capital costs for banks, especially for RCF commitments to lower-rated companies. Our bankers' business cases to their credit committees demand a valuable chunk of ancillary.

It's part of a banker's DNA to never be completely satisfied with their corporate clients – a bit like a football manager who wants more even after his team has thumped their biggest rivals 5-0. Our corresponding requirement is to detect when any professed hardship on a bank is genuine. Expectations management is key: we control the message, so we have to reflect on how any bankers end up with a distorted picture of the business that's coming their way.

> It's part of a banker's DNA to never be completely satisfied

Appropriate allocation

The question is, how do we build a framework to allocate our ancillary business appropriately? And how do we monitor this to support the ongoing bank relationship? Before we even start, we need visibility over the group's potential ancillary business. Then we need to influence outcomes to deliver business to our relationship banks, while meeting the needs of local management.

Next, we need to record and quantify what business has been won by each bank – and, importantly, the associated fees. Also, the opportunities they've had access to, and where they've come up short. This isn't a ground-breaking theory, but, anecdotally, such granular feedback to banks is far from common.

Dealing platforms offer the type of reporting that we need for this purpose – our challenge is to extend these templates to capture the less-easily-quantifiable metrics. And that's before we think about any low-value (today), but highly symbolic (future), business, for example, the appointment of the local banker in a key growth market.

Approaches will vary. Consider a FTSE 20 – with M&A and financing mandates, global banking and plenty of hedging – alongside a FTSE 350 with no international exposures. Many large corporates rank their banks in tiers, reflecting levels of participation in committed facilities. Rewarding major players with access to the most attractive tickets and incentivising progression within the bank group over time are powerful tactics. Although they may discourage smaller lenders, bigger corporates can often live with this.

Our approach reflects our size, international reach and credit status. New entrants to the bank group need a warm welcome, and banks that have stepped up their commitment to support the company's financial development are due their reward. All the while, we must be mindful of the need not to punish our long-standing relationships that have supported the business over the years.

Balancing act

So, our most significant ancillary business will continue to go to our biggest lenders, but FX and commodity hedging will be open to all. Cash management and other local mandates could be appointed rather than subject to competitive tender processes. Instead of including every bank on every deal, the geographic profile and product strengths of our banks will allow us to compile appropriate shortlists. But still, it is quite a balancing act.

And, ultimately, we'll know how successful we've been when we next refinance our RCF. Happy bankers will maintain, and maybe even increase, their bank's commitment.

The Treasury Insider works in corporate treasury at a well-known institution in the UK


ACT
ACT ANNUAL DINNER 2015
The premier networking event in the corporate finance calendar.
11 NOVEMBER 2015
Grosvenor House Hotel, London
Dress code: black tie
OPEN FOR BOOKINGS
treasurers.org/annualdinner

A new deal for Greece

The eurozone's most troublesome member may finally have clawed its way back from the brink, suggests Holger Schmieding

Few economic issues have made more global headlines in the past five years than Greece. Many observers in the UK have denounced the new deal that Europe has just struck with Greece as far too harsh, condemning the small country at the European periphery to years of further misery. This is a quite lopsided view, to put it mildly.

First of all, we have to put Greece into perspective. It accounts for less than 2% of the eurozone economy, roughly equivalent to the share of Northern Ireland in the overall UK economy. While Northern Ireland sometimes made grim political headlines across the world in past decades, it never influenced the overall direction of the UK economy very much. In the same vein, Greece poses serious political questions for the eurozone. How to deal with a country that has badly flouted the rules of the club, but seems to be of some strategic importance? But its fate is not decisive for the eurozone economy or its currency, the euro.

Second, much of the most recent debate about Greece neglects one simple fact. In the autumn of 2014, Greece was finally on the mend, with annualised GDP growth of 2.3% from Q1 to Q3, and a 2.4% year-on-year rebound in employment in Q4. Exports were rising nicely, the banks had been recapitalised, business confidence had surged to above the eurozone average. In short: the Greek economy was on the right track. Leading economic indicators were projecting some 3% economic growth for 2015.

Then came Greek prime minister Alexis Tsipras and his flashy, but grossly incompetent, finance minister, Yanis Varoufakis. By making impossible promises to voters who had suffered badly in the years of crisis before, the radical left won snap elections in January 2015 and formed a coalition with an equally economically illiterate party from the right-wing fringes. The result has been similar to what we might expect from a coalition between, say, Jeremy Corbyn and Nigel Farage in the UK.

ILLUSTRATION: SHUTTERSTOCK

Observers in the UK have denounced the new deal that Europe has just struck with Greece as far too harsh, condemning the small country to years of further misery

Within seven months, the radical left gamblers of Athens had driven capital worth a third of Greece's annual GDP out of the country, busted the banks and threatened to push the economy back into recession. The only way to prevent Greece from turning into another populists' paradise like Venezuela, just without the oil, was to stop the reform reversals of the Tsipras government. That is what the deal is about. That is why it is a good deal, warts and all.

Missing the point

Many observers complain that the new deal imposes excessive austerity onto Greece. There is a kernel of truth in there. Europe has indeed insisted that some of the costs caused by the first six months of Syriza misrule have to be borne by Greece, mostly through clamping down on early retirement and raising sales taxes on some products. But these observers still miss the major point. As part of the package of fiscal cuts and structural reforms, Europe has promised Greece that it can get up to €35bn in European funding for infrastructure and other investment if the administration manages to present suitable projects to Europe. If Greece gets its act together and actually claims this money, the additional investment spending in the country would exceed the fiscal savings it has been asked to make.

Should Tsipras return as Greek prime minsiter following the snap election he called for September, he will have to implement the opposite of many things he had promised his voters in January and June. But the deal offers Greece the chance to get back on the reform track, which has already led Ireland and Spain back to vigorous economic growth.

Holger Schmieding is chief economist at Berenberg. You can follow him on Twitter @Berenberg_Econ

Restoring public trust

How is the ACT helping to improve professional standards within the financial sector? David Craik explains

Public trust in the professional standards of the financial services industry has been decimated by the eruption of the global financial crisis in 2007, followed by a series of other scandals, including the well-publicised rigging of Libor.

But gradually, thanks to a concerted effort by industry and government, the damage done to the industry's reputation is beginning to mend.

One indicator of this is the recent Chartered Banker Professional Standards Board (CB:PSB) *Progress Report 2015*, which revealed that its own pioneering new industry qualifications, such as the Foundation and Leadership Standards, aimed at regaining public confidence and professional pride in the sector, have shown remarkable progress.

A key report survey found that the creation of the standards, combined with growing public understanding and knowledge of them, had helped 41% of UK adults in 2014 to have "some or high confidence and trust in the banking industry" compared with 31% in 2013. Greater industry pick-up and recognition of the standards has also seen the amount of banking employees who feel a "lot of pride" in their profession doubling over the past 12 months.

It is an encouraging trend and one that the ACT can take huge pride in, given CEO Colin Tyler's position on the CB:PSB's advisory panel.

This commitment to enhancing professional standards in financial services is no one-off, either. Indeed, over the past three years, the ACT has played a fundamental and often unseen role in helping to restore trust and standards throughout the financial sector. Among the projects that it has been involved in are the Hogg Committee that advised on Libor, the Fair and Effective Markets Review (FEMR), the Lambert report that established the Banking Standards Board, and supporting the Asset & Liability Management Association's first qualification.

> "We want the right people to come into financial markets and need to encourage them by showing them more examples of good practice"

"There are quality people in the financial market with the right behaviour and good integrity," Tyler observes. "We had a bit of a knock from the financial crisis. The reputation and functioning of the market was damaged and from that there was a demand for cultural change and more competent behaviour. We have been an important player in developing that change."

As a representative of the 'buy side' of the market, the ACT's work on the Hogg Committee was particularly pivotal. The committee was set up to recommend a new administrator for Libor following the rate-rigging revelations of 2012. Tyler sat on the committee alongside chair Baroness Hogg and other major financial leaders, such as Martin Wheatley, chief executive of the Financial Conduct Authority. Set up in 2013, the committee eventually selected securities exchange operator NYSE Euronext as the new Libor administrator.

Ethical approach

"There had been a number of examples of poor selling and I was approached to sit on the committee," Tyler recalls. "At the ACT, we have a reputation for quality, being ethical in our approach and considered in our thinking. Where we can, we will contribute in trying to develop best practice elsewhere, such as in Libor. We brought that knowledge and understanding of how to develop better ethical behaviour to the committee."

John Grout, ACT policy and technical director, adds: "We saw an important need to benchmark the rate element of bank credit risk. Our role was to be the rational observer from the user group that we represent, which is from the financial, customer and supply side of the economy. We can do this in a way that the busy treasurer of a multinational can't do. We bring a viewpoint, expertise and awareness that people deeply embedded in the financial services sector don't have."

The concentration on ethics mentioned by Tyler has long been integral to the ACT. It has a well-established Ethical Code that defines areas, such as integrity, courtesy and consideration, and professional competence; an advisory board that sits above its council; and even the Archbishop of Canterbury, and former treasurer, Justin Welby Hon FCT as confidential adviser to ACT members on ethical and personal issues.

"We do the right thing; it's typical of us," says Tyler. "In terms of ethics, treasury practitioners are very well advanced. There hasn't been enough professionalism across other financial markets before and people are starting to demand it."

Grout adds: "The ACT has always had a public interest attitude. We provide a network of learning and development for current and future treasurers. As part of that, we emphasise conduct, responsibility and ethics, not just in their position of treasurer or what is important to their company, but also what is important to society as a whole."

The association's strong ethical and professional training heritage – the ACT's first-ever professional treasurer exams were held 30 years

IKON IMAGES/SALLY ELFORD

Chartered Banker Professional Standards Board *Progress Report 2015*

The Chartered Banker Professional Standards Board (CB:PSB) is a joint voluntary initiative led by eight leading UK banks and the Chartered Banker Institute. It is professionalising banking by developing, implementing and sustaining professional standards, underpinned by a common Code of Professional Conduct.

More than 185,000 bankers achieved the Foundation Standard in 2014 – 117,716 in the UK and an additional 69,600 globally. This was up 61% in the UK compared with 2013.

The new Leadership Standard for senior bankers is being piloted in 2015/16. In it, the CB:PSB sets out what customers and other stakeholders can expect from banking leaders: how they ought to conduct themselves and inspire, lead and motivate others to act professionally.

The ACT sits on the banking user-focused advisory panel, which supports the work of the CB:PSB by sharing the vital view of banks' customers and stakeholders.

Advisory panel chair Robin Jarvis says: "My panel colleague, Colin Tyler, provides valuable input, representing the views of corporate treasurers and bringing his own experience to help shape the development of banking standards. These professional standards set conduct and expertise requirements, defining – for the first time – professional norms for bankers."

ago – also played its part in it being approached to support both the CB:PSB and the Asset & Liability Management Association's first ever professional qualification.

"The Asset & Liability Management Association has been going for 21 years without a professional qualification and we've been supporting them in that. They are not just developing an educational qualification, but adopting best practice," Tyler says. "It is something we should encourage to try and restore faith in the market."

On the issue of trust, the ACT has been further called upon to help raise banking standards via the Banking Standards Review, led by Sir Richard Lambert. Its report recommended the establishment of the Banking Standards Review Council (BSRC), an independent body setting standards of good practice, and demanding better and more ethical behaviour.

The ACT, which met privately with the review group, supports the proposals, including a recognition of company codes of practices, training schemes and qualifications issued by other bodies, and benchmarking them against the BSRC's own minimum standards.

It was another ACT strength – that of being able to canvass and strongly reflect the view of its members – which played a huge part in the FEMR on how to improve the fairness and effectiveness of the fixed income, currencies and commodities markets.

On Her Majesty's service

With all of these major structural reforms, it was the ACT that was sought out and approached by government for its views.

"We are not a large enough organisation to bang the drum all the time," Tyler explains. "But we are happy to respond to requests for help and to be one of the professional bodies helping to restore faith in the financial markets. It is important we work collaboratively. There is no point being an apologist for the banks or needlessly scoring points off them. It is about ensuring that people

don't feel they are being ripped off and getting there as quickly as we can. We will give that our full engagement."

Does he feel this is close to being achieved? "The reality is that there is still some way to go. The political environment still wants someone to blame, but there will come a time, in a few years, when public perceptions will have changed. Yet you have to build up that respect," he states. "I would like to see more encouragement from the regulators in terms of showing best practice when it occurs. It is difficult to find a good news story. The reality is that there are some fine people doing fine things and just not getting that visibility. We want the right people to come into financial markets and need to encourage them by showing them more examples of good practice."

According to Tyler, that also means "leaders of individual banks showing strong leadership and realising that education of their staff has an important role to play".

Grout adds that business leaders also need to understand the importance of corporate governance to future success. "If there is a corporate governance failure, a company will suffer major reputational damage, which will affect its credit standing and risk. Corporate treasurers must help to ensure that a company's credit standing and corporate governance are proper. A treasurer's credibility is on the line every day."

The ACT has continued to develop its own in-house training programmes, which range from short skills-based courses to certifications in areas such as Treasury Fundamentals, Treasury, and International Cash Management, as well as a Diploma in Treasury Management.

Many of these are now also being delivered online through the new ACT Learning Academy flexible study system that has online study guides and online tutor support.

"We want to ensure that there is targeted support for our members throughout their career, not just on day one," Tyler explains.

Another online development, which is currently being pitched to ACT members, is the Capability Analysis Tool. This will allow members to perform their own personal skills gap analysis using an online questionnaire. From that, programmes can be designed to ensure that areas of development and skills shortage are adequately covered.

"We can evaluate what skills they have and where the gaps are," Tyler explains. "It shouldn't be a surprise to us that we have a skills gap. Employers are crying out for better quality skills and our job is to help close that gap. If not, then we will not get the growth in the market that we need."

ACT achievements

So what does the rest of industry think of the ACT's efforts?

Bob Williams, regional finance director for housebuilder Barratt Homes, believes that the ACT has been a key player in lifting the quality of treasury management in the UK and helping members to better understand and cope with an ever-changing regulatory environment.

"The ACT has ensured that regulatory change is appropriate and balanced," he says. "It would have been too easy for regulators to take too far a swing away from risk following the crisis. We needed a happy medium to ensure that the objectives of all sides were met. The ACT is the market leader in understanding what its members' corporations required and filtering that into a healthy debate with government."

David Clark, chairman of the Wholesale Markets Brokers' Association, adds: "The ACT has made key contributions to restoring standards and trust. It doesn't just come with its own ACT view, but an industry-wide-specific one. It is very collegiate in that respect. Given the corporate borrowers' crucial use of Libor, a solution could not have been reached sensibly without its input."

A combination of its long-held commitment to ethics and training, and a deep understanding of its members' needs and opinions, has helped the ACT to contribute much to the reputational recovery of the financial sector.

"Much of what we do is not in the public glare," Grout states. "We are a small voice, but we try and nudge things in a sensible direction as quickly as we can. We improve proposals. That is our success."

FAIR AND EFFECTIVE MARKETS REVIEW

The Fair and Effective Markets Review (FEMR) issued a consultation in 2014, seeking views on the fairness and effectiveness of the fixed income, currencies and commodities markets.

The ACT's policy and technical team attended meetings with two of the three review chairs, with FEMR also attending a discussion with treasurers in the ACT's offices. Several treasurers also attended a round table at the Bank of England.

The ACT provided a written response that emphasised:

- **Non-financial companies and other non-financial organisations do want to use available, honest, open, reliable and fair markets.**
- **Fairness and effectiveness require the idea of proportionality. Non-financial market users are a small part of most fixed-income instruments, currencies and commodities (FICC) markets. Regulation of, and oversight processes for, financial services applied to non-financial services organisations are often disproportionate, costly and discouraging of real-economy activity.**
- **Non-financial clients are unlikely materially to contribute to 'market discipline'. Abuse by a bank in one area of FICC is unlikely to prompt a non-financial organisation to materially change its attitude to the institution. The activity directly affected is likely to be only a part of an often very broad relationship. The disruption and cost of redirecting business, particularly if it involves operating rather than treasury units of the organisation, is high.**

"The ACT has made key contributions to restoring standards and trust. It doesn't just come with its own ACT view, but an industry-wide-specific one"

David Craik is a freelance business journalist

IKON IMAGES/SALLY ELFORD

OILING THE WHEELS

What's it like working in the treasury of Europe's largest company by revenue? Ian Chisholm, Shell's vice president financial markets, explains

Words: **Sally Percy** / Photography: **Will Amlot**

As far as professional treasuries go, it must be hard to beat the set-up at energy giant Shell. With a staff of around 300, its responsibilities encompass treasury operations, pensions, risk and insurance, as well as M&A and commercial finance. So there's plenty of scope for career progression for its talented treasury team.

This explains why Ian Chisholm, the company's vice president financial markets, has stayed at the company ever since he joined Shell's finance graduate scheme after studying geology at Cambridge. "There are a wide range of opportunities in such a big company," he says, "and Shell's full of talented people. It's an important industry meeting the energy needs of society, and comes with a huge number of technical, environmental and financial challenges."

Further adding to the company's appeal, Shell is "a very strong supporter of the ACT", according to Chisholm, who has sat on the ACT's council since 2013. "We're also strong supporters of competence development. We've had our own competency framework for many years, so I'm delighted to see that the ACT has introduced theirs. For me, the ACT is the benchmark of treasury education."

Today, Chisholm heads up Shell's financial markets team, reporting in to group treasurer Russell O'Brien, and he is responsible for debt and equity capital markets, as well as credit rating agency relationships and treasury compliance – a role that he says has got even more interesting due to the proposed merger with rival energy company BG Group. During his career, he has worked in all of Shell's treasury functions except risk and insurance, and he has travelled extensively with the company – when he worked in M&A, he was responsible for gas and power projects in the Far East.

What he likes about treasury is the fact that treasurers get to make decisions – financing decisions or risk management decisions – and they get to see the results of those decisions within a relatively short space of time. "In a lot of finance roles, you're supporting the decision-makers," he explains, "but in treasury, you really are the decision-maker."

Strategic partner

At Shell, treasury also plays an important role in helping to set group strategy. Chisholm prepares an annual financial strategy paper, which is presented in tandem with the business plan to the board in December each year, and O'Brien regularly presents to the board on treasury issues.

Financial strategy matters because of the scale of Shell's activities – it is the world's 13th-biggest company, according to Forbes, and it operates in more than 70 different countries around the world. And the nature of its business means that its projects are ambitious and capital-intensive. For example, it is investing billions of dollars in building the world's first floating liquefied natural gas facility, the 488m-long Prelude. Once it has been completed, Prelude will take gas from offshore Australia, then convert it into a liquid for transportation around the world.

The challenge with Prelude from the Shell treasury perspective is not just funding it, but also insuring it. "The question is, how do you insure the biggest vessel in the world?" Chisholm queries. "We have to take a lot of that exposure onto our own balance sheet. We do a lot of self-insurance because the insurance markets have limited capacity for such risks."

He continues: "We think we have a more informed view of our business and our loss history, which means we understand the risks better than the insurance market does. We have captive insurance companies that will provide insurance cover to our individual operating companies and which will respond if there's a claim. So we're retaining the risk within Shell."

Rules and regulations

Shell's treasury regards itself as cutting-edge, but it's not just its insurance activities that set it apart from other treasuries. Another good example is its engagement in the regulatory debate. Besides managing FX and interest-rate risk, Shell also uses derivatives to manage the large exposures arising from the group's commodity trading business – which makes talking to regulators a necessity.

"We are directly affected by some regulation – all the efforts on derivatives, for example," says Chisholm, "but we are indirectly affected by a lot of financial regulation because we are a major user of financial services."

Asked whether Shell is able to make a difference through its engagement in the regulatory debate, Chisholm responds: "I think we do, but the regulators have a lot of different constituencies lobbying them. We want to make sure that regulators listen to both sides of the story because the financial services side is very busy lobbying, too."

Sanctions are another concern for Shell. "We comply with all applicable sanctions," Chisholm explains. "We monitor them extremely closely because we need to ensure that all of our processes are compliant. Our Russian operations are carrying on, but the new investments there are not getting financing. We don't have any operations in Iran, but we have been unable to pay $2bn to the National Iranian Oil Company for crude that we lifted prior to sanctions. When sanctions are fully removed, we will pay that."

Shell's treasury has needed to invest a significant amount of time and attention in its payment process to ensure that it is fully compliant with sanctions. "The banks are much more focused on this area than they have been in the past," comments Chisholm, "and they will stop payments if any red flags come up. If one of our cash management banks says, 'Here's a payment to so-and-so, and it's got the name of somebody who's on the sanctions list', we have to check our due diligence processes to make sure that the payment is valid and the red flag is a false alarm – for instance, if it's someone else with the same name."

Oil price shock

As Europe's biggest producer of oil, Shell has inevitably felt the impact of the recent slump in oil prices. "Clearly, the oil price is a significant challenge for us," notes Chisholm, "because it is the main driver of our revenues. For every annual $10-per-barrel move in the oil prices, there's an annual impact on our cash flows of $3bn."

To a certain extent, however, the nature of Shell's business helps to shield it from the full impact of the fall in oil prices. Besides its upstream extraction business, it also has its downstream refining and marketing business, to which oil is an input. "The downstream business generally makes more money in a lower oil price environment," Chisholm explains. "So it's a natural hedge."

Meanwhile, the oil industry's costs fluctuate along with the oil price. "We saw a lot of cost inflation when oil prices went up to $100 per barrel and stayed there for several years," says Chisholm. "So the current drop in oil prices is also an opportunity for us to reset the cost base. We will cut back on capital expenditure and operating expenditure, and look at ways to take cost out of the supply chain."

The biggest challenge that the fall in oil prices has presented to Shell's treasury is the resultant fluctuation of cash flows. "When I'm looking at funding the group, we look at our cash-flow forecast one to two years out," Chisholm explains. "The biggest driver of cash flows is the oil price, which gives a huge amount of variability to the cash-flow forecast. We know that the one-to-two-year forecast is always wrong, but we still need to look at the different scenarios for that forecast in order to ensure that we have sufficient liquidity available."

Cash is king

Talking of cash, this happens to be something that Shell has rather a lot of. At the end of the second quarter of 2015, the group had around $27bn in cash reserves, up from $9.7bn at the end of 2013. "We will run with large cash balances because we have large business cash flows, large financing cash flows and large working capital cash flows," Chisholm explains. "It was a little higher than usual at the end of 2014 because we could see the way that the oil price was moving, so we borrowed around $3.6bn from the capital markets in November."

Shell needs to be able to invest in multibillion-dollar projects throughout the commodity cycle. Therefore, it takes a conservative approach to funding in order to maintain a strong balance sheet and to protect its prized AA credit rating. "The rating is there to support the business and it is something we have that allows us to say to host

VITAL STATISTICS

#1
Shell is the largest oil producer in Europe

13
Shell's position on the Forbes 2015 list of the world's biggest public companies

70+
the number of countries in which Shell operates

94,000
the number of people employed by Shell

18.1%
the proportion of Shell's senior leaders who are women

3.1 million
the number of barrels of oil equivalent that are produced by Shell every day

$3.7 trillion
the amount of cash flow that passes through Shell's bank accounts on an annual basis

$421.1bn
Shell's turnover in 2014

$23.9bn
the net capital investment made by Shell in 2014

$27bn
the amount that Shell held in cash and cash equivalents at the end of Q2 2015

$53bn
the amount of debt Shell held at the end of Q2 2015

$160m
the amount that Shell spent on voluntary social investment worldwide in 2014

"Clearly, the oil price is a significant challenge for us, because it is the main driver of our revenues. For every annual $10-per-barrel move in the oil prices, there's an annual impact on our cash flows of $3bn"

governments: 'We have the balance sheet strength for these multibillion-dollar projects,'" says Chisholm.

The group's cash balances are funded primarily through capital markets debt, rather than bank financing. "We go to the capital markets whenever we see a good opportunity," says Chisholm. "The mantra of our previous group treasurer, Andy Longden, was: 'You issue debt when you can, not when you have to.' If that means we hold a little more cash sometimes, then so be it."

Until it's spent, the money raised on the markets is invested in a variety of instruments, including bank deposits, money market funds, corporate commercial papers and tri-party repos. Chisholm sits on the Shell treasury credit committee, which continuously monitors the credit quality of the company's counterparties.

Variety matters

Out of all the roles he's had at Shell, Chisholm particularly enjoyed managing the group's UK defined benefit pension fund – to his own surprise. It was the variety of tasks that made the job so interesting, he says. "One day I'd be talking about investment strategy with the fund manager and the next I'd be talking to Shell pensioners about the economy." The job was made more challenging by the fact he started it on 15 September 2008, the day that Lehman Brothers collapsed.

He recalls: "My first call was to our in-house fund manager, saying, 'What have we got with Lehman's?' And we did have some inflation swaps, but they were fully collateralised, so our losses were minimal. But it goes to show the critical importance of good treasury management around all of your counterparties."

Looking back on the career that began in 1989, when he was a fresh-faced graduate, Chisholm says: "The biggest lesson I've learned during my career is that if I enjoy what I'm doing, I will do it well, and the rewards and progression will follow. I'm not advocating doing the same job all the time. It's also very important to get variety, so sometimes you need to take risks to find out the things you might find interesting and enjoy."

IAN'S TOP TIPS FOR SUCCESS

1. **"You need to be the respected expert, so education and competency development are key. But you also must understand the business drivers and have a view on how the external environment impacts on the business."**
2. **"The MCT is treasury at the strategic level. It has helped me to understand how to come up with solutions to the complex, multi-dimensional problems that you get in treasury. It's also vital to progression to the most senior roles."**
3. **"My favourite gadget is my sit-stand desk because I've had some back problems recently. It's dramatically improved my posture over the past six months."**
4. **"Treat everyone that you come into contact with as you would want to be treated yourself."**
5. **"The most difficult question that my CFO is likely to ask is: 'Can you give me a quick briefing on the latest financial regulations that impact Shell?' Because it's never quick!"**
6. **"The best way to unwind after a stressful day is to cook for family and friends, and enjoy a nice glass of wine."**

IAN'S CURRICULUM VITAE

2012-present
Vice president financial markets, Shell

2008-2012
General manager, UK Pension Fund, Shell

2007-2008
Global treasury operations manager, Shell

2004-2007
Treasurer, gas and power, Shell

2001-2004
Senior M&A adviser, Shell

1989-2000
Finance and treasury roles, Shell

Qualifications
ACMA (1993); MCT (2000)

Sally Percy is editor of *The Treasurer*

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15-PAGE SPECIAL

CASH & LIQUIDITY MANAGEMENT

"The development of multiple payment types is increasing the pressure on these businesses as consumers demand the ability to make payments through Apple Pay, for example. Many companies will have little choice but to accept a wider variety of payment types"

IMAGE SOURCE

What's the alternative?

A HOST OF INNOVATORS ARE CHALLENGING THE POWER OF THE BANKS THAT HAVE TRADITIONALLY DOMINATED THE PAYMENTS INDUSTRY. PAUL GOLDEN EXPLAINS HOW

Payment applications developed by companies outside the traditional banking system account for a growing share of financial transactions, raising the prospect of lower payment-processing costs for corporates.

According to international consulting firm Accenture, competition from non-banks could reduce traditional bank revenues by a third by 2020, with payments one of the most hotly contested areas.

Meanwhile, the most recent edition of the alternative payments report, produced by payment-processing provider Worldpay, reveals that the value of payments processed by more than 300 alternative payment schemes in operation globally rose by 21% in 2013. It estimates that they will account for 59% of transactions by 2017.

One of the most commonly referenced benefits of alternative payment systems is reduced transaction costs, although Stephen Baseby, ACT associate policy and technical director, says that the costs faced by businesses vary widely.

"The higher the transaction volume and average transaction size, the cheaper electronically processed payments are, which means that processing costs can be surprisingly low for a large utility relative to income, but high for a small retailer," he explains.

Interchange fees – the fee paid by a merchant's acquiring bank to a cardholder's issuing bank as part of an electronic payment card transaction – are in flux (see box on page 31) and the impact of recent changes is not yet clear, Baseby continues.

He says: "Most of the payment applications generate a Faster Payment, which accounts for the bulk of the cost. Payments made via Faster Payments – a UK banking initiative to reduce payment times between different banks' customer accounts – remain expensive relative to debit cards. This is partly down to the volume of transactions, although that should change as volume increases."

Daniel Blumen, founding partner of consultancy Treasury Alliance Group, observes that, for businesses that deal with individual consumers, payment processing and interchange charges can be a significant expense.

"The development of multiple payment types is increasing the pressure on these businesses as consumers demand the ability to make payments through Apple Pay, for example," he says. "Many companies will have little choice but to accept a wider variety of payment types."

As a result, Blumen says it is difficult to predict whether the growth of alternative payment will drive down costs. "This could be the case, but then there is the added cost of accepting a large number of payment methods. What makes alternatives such as Dwolla and PayPal attractive is that some of the cost of the payment falls on the consumer."

Convenient for customers

Homer Wu, treasurer at international retail marketing firm TCC, observes that some alternative payment mechanisms are simply a means of storing credit cards digitally, since consumers still need to have a credit or a debit card to make use of payment systems such as Google Wallet.

"The value proposition for the consumer is the increase in convenience, and the attraction for the retailer is to reduce the time required per transaction," he says. "In this scenario, I don't see how alternative payment systems >

reduce processing fees, unless you take that time saving into consideration."

No matter how the payment is instructed, it will end up in the banking system for delivery unless an alternate system, such as Bitcoin, is used, agrees Baseby, adding that delivering usable funds is a major challenge for alternative payment providers.

"You can have as many retailers, providers and end users as you want, but the core transmission networks are monopolies, so who is going to be able to justify building a parallel network?" he adds.

Blumen states that, while there has been a rush of investment into new payment systems, it is hard to say exactly how many alternative payment services the market could support, and that there will be an inevitable shakeout in the industry.

"Alternative payment providers would love to use their own platforms and operate a closed loop – such as Bitcoin – since costs are lowest this way," says Blumen. "But that requires the buyer and seller to be on the same system, which is asking a lot. The banks are also fighting back with their own customer-to-customer options, which do not use the conventional clearing systems, such as ACH [Automated Clearing House]."

Treasury Alliance Group's view is that companies that offer an easy front end into existing systems (such as Dwolla) will do well, while systems that require closed loop will be appealing in the short to medium term until a major fraud event leaves those holding large amounts of Bitcoin out of pocket.

Gene Neyer, senior vice president product management at transaction banking software provider Fundtech, observes that initiatives such as merchant-owned mobile commerce network MCX have been slow to take off and that payment mechanisms with very low fees and no interchange are not being adopted widely.

Yet he also states that the new European Payment Services Directive is creating a competition framework, where alternative providers can insert themselves between the consumer and their banks, which is expected to significantly increase the number of alternative providers and competition.

"The significant issues are the capital requirements necessary to implement the new EMV [an open-standard set of specifications for smart card payments and acceptance devices], which many smaller retailers will not be able to afford, and the shift in the liability model for fraud," says Neyer.

Working smarter

"Alternative providers will continue to use the banks' infrastructure, but in smarter ways, such as netting, grossing up, offsetting debits/credits and implicitly extending (micro) credit based on alternative criteria," Neyer continues. "Those with roots in cryptocurrency are looking to create a new platform in the form of block chains and

"Until there is standardisation in how these transactions are conducted, it may be cumbersome to offer access to multiple mobile payment types"

IMPLICATIONS FOR TREASURY

One of the most intriguing potential applications of alternative payment systems is for making and receiving corporate treasury payments. A number of treasury management system providers are understood to be looking at how their systems might support alternative payment applications.

But RB Erickson, director of global sales enablement at treasury software company Kyriba, says he is unaware of any corporate treasury department using mobile payment solutions.

"I suspect that we will see the adoption of Google Wallet and Apple Pay from the receivables side. For corporates that receive online retail payments from customers, corporate treasury may monitor these from a forecasting or cash-balancing perspective. But while corporate treasuries may not elect to make their own payments via Google Wallet or Apple Pay, some may require links with these payment methods to project incoming cash flows or set cash balances."

Treasurers are not likely to use even established payment methods such as credit cards to initiate payments because most of them are supposed to be almost free and executed quickly, adds Jerome Albus, senior vice president of payments and messaging for SunGard's corporate liquidity business.

"In that context, treasurers are better served by having the smallest number of intermediaries to avoid additional fees from the credit card providers. Also, treasury payments often involve a multitude of accounts, whereas a card is attached to a single debit account. Some companies have hundreds of debit accounts and treasurers would not want to manage or run the risk of having a payment card attached to each one of them," says Erickson.

open shared ledgers. As soon as they are used to transfer and store funds, however, they immediately come under the regulatory umbrella and, at a minimum, must become registered money transmitters."

Despite the challenges outlined above, Nick Holland, head of mobile at Javelin Strategy & Research, floats the possibility of Apple starting its own payment network and expects alternative payment providers to look at acquiring money-transfer licences.

Holland says some may become banks in their own right or absorb existing banks. "We will also see traditional payment providers building out person-to-person networks with real-time transfer of funds."

According to Paul McMeekin, director, market intelligence, at electronic banking solutions provider ACI Worldwide, the major competitive concern for banks is that Google will give away the transaction and become a 'real' bank. This point is taken up by his colleague Mark Ranta, who says that Google is happy to forgo the transaction fee to earn multiples of that amount on the associated advertising space.

McMeekin says there is considerable potential for tie-ins between banks with sizeable market share and companies that bill large numbers of customers, such as mobile operators. "If an operator worked directly with a bank, it could develop a smartphone app that would allow the customer to directly access their funds."

One potential obstacle to such partnerships is data ownership, adds Ranta. "Both the bank and the merchant will want to own the customer data, but the network operator will also stake a claim to it. There will have to be sharing of information between all parties."

Merchants may accept multiple payment types, but will, at some point, reach a limit as to how many they can support at the register, says Steve Kenneally, vice president at the American Bankers Association's Center for Payments and Cybersecurity.

"Until there is standardisation in how these transactions are conducted, it may be cumbersome to offer access to multiple mobile payment types," he concludes. "Right now, it is not clear if the best way to make payments faster, safer and more efficient is to build upon a legacy system like the ACH or card networks, or to create a brand-new platform with technology specifically for real-time payments."

IMAGE SOURCE

THE COST OF PAYMENTS

Richard Koch, head of policy at the UK Cards Association, describes payment processing and interchange fees as part of the costs of doing business. He refers to a European Central Bank study, undertaken in 2012, which found that card-acceptance costs amounted to less than 0.2% of retailers' total costs.

Yet Nick Holland, of Javelin Strategy & Research, observes that there is deep dissatisfaction among US retailers with the two major card companies in relation to the interchange fees they charge.

In the UK, the Payment Systems Regulator (PSR) is undertaking a study into payment card systems, including the fees charged to the businesses that use them. A 'call for input' was published in late June on issues such as the impact of the EU Interchange Fee Regulation.

As well as gathering views and information on how people think the Interchange Fee Regulation will work in the UK and developing a policy for monitoring compliance, the PSR is also seeking views on possible concerns around indirect access and governance of card payment systems.

A spokesperson for the regulator said that one of its key roles was to open up payment systems so that more people are able to access them. "To support this, we must promote the development of technical access solutions that should ultimately contribute to driving processing fees down."

One of the PSR's proposals is that innovative payment service providers should be able to gain direct access to payment systems on fair terms.

Paul Golden is a freelance journalist who specialises in writing about finance

Turbocharging working capital

HOW CAN MIDDLE-MARKET BUSINESSES UNLOCK HIDDEN VALUE WITH SUPPLY CHAIN FINANCE? ROBERT BARNES EXPLAINS

ILLUSTRATION: IMAGE SOURCE

Treasurers know that providing their business with sufficient working capital is a delicate balancing act, which requires experience and flexibility. As with so many other business functions, the operations of the treasury experience continual change and are subject to the impact of social and economic factors.

As economic recovery from the financial crisis continues apace, the challenges faced by treasurers as a result of 2008 are still to be fully resolved. Traditional forms of short-term funding, revolving around pre-existing banking arrangements, have become scarcer and more expensive. As a result, many businesses have sought alternative sources of capital. While a treasurer has historically concentrated upon external sources of funding, this search for alternatives has led many treasurers to turn their focus inwards, and consider funding solutions based around working capital.

The business case for strong working capital management is comprehensive. In addition to the direct availability of capital without recourse to expensive bank finance, evidence also suggests that prudent working capital management has a strong positive correlation with profitability of businesses.[1]

Well-managed working capital improves a company's position within the market, both in terms of liquidity and in the growth of shareholder value,[2] and stringent management of working capital has become a hallmark of prudent business administration in the wake of the financial crisis.[3]

In addition, fast, low-risk and low-cost access to capital can allow businesses to be agile in the market and make rapid tactical decisions before their competitors. The financial crisis has only sharpened the case for focusing upon working capital management in businesses of all sizes.

One such source is the optimisation of working capital through the supply chain. A number of solutions have been adopted, mainly by the largest investment-grade businesses, all of which seek to enhance working capital management and release funds that are essentially dormant.

Popular solution

Working capital management can take a number of forms. One solution, which is growing rapidly, at an annual rate of 20-30% globally in the near term, is supply chain finance (SCF). While this solution is becoming mature in large, investment-grade businesses, it is still novel for unrated or sub-investment-grade and middle-market companies.

Of most direct importance to treasurers, SCF can improve working capital. It reduces the reliance upon external sources of funding by unlocking previously dormant capital within the supply chain.

There are also numerous broader benefits, which will be felt by the entire business. Although treasurers have a clear and distinct remit, no function exists in isolation and SCF can catalyse positive impacts across a business. The benefits of SCF can extend beyond the direct effect of improved working capital.

SCF can deliver what is being termed 'the collaborative supply chain' to the middle market. This 'win, win, win' system has positive effects for buyers, suppliers and funders. By offering suppliers improved payment terms, the buyer-supplier relationship is strengthened, as is the working capital of the suppliers. Taken in tandem, this strengthens the supply chain. A strong supply chain is a genuine benefit when most businesses operate lean supply chains and are reliant upon the performance of their suppliers.

SCF and the middle market

Besides the direct working-capital benefits that it offers, there is a compelling broader business case for the exploration of SCF. So why has this solution not been more widely adopted by businesses of all sizes before now?

The answer mostly relates to business size. These solutions have traditionally been targeted at the largest businesses – those with complex supply chains. Recent research has focused upon treasurers at investment-grade public companies, without serious consideration of the middle market. Yet access to working capital can have a similarly transformative effect for any business with a supply chain, irrespective of size.

From the perspective of unrated companies, the complexity and administrative burden of integrating an SCF solution may not be justified by the pay-off in releasing working capital.

Technology-enabled platforms can rebalance this equation, however. Platforms that seamlessly link with existing accounting software are entering the market, which vastly simplifies installation, operation and reporting. Allied with fast and accurate rating of invoices and total control over invoice

SCF delivers the opportunity for treasurers to access increased working capital and reduce reliance upon bank funding. It also offers a broad range of benefits to the wider business

management via simple and customisable dashboards, SCF can make the transition from an attractive concept to a practical reality for middle-market companies. This means that medium-sized businesses could enjoy benefits that have only previously been available to the largest businesses in terms of access to capital, supplier loyalty and resilient supply chains.

As a result, there are signs that medium-sized businesses may be waking up to the potential of SCF, albeit slowly. ACCA's Global Forum for SMEs cited SCF as one of the most promising tools available to growing companies in 2014. Its report, *A study of the business case for supply chain finance*, carried out by research firm Aite Group, cited that SCF solutions could serve an estimated market worth $255bn to $280bn globally, thereby offering enormous opportunities for growth.

SCF delivers the opportunity for treasurers to access increased working capital and reduce reliance upon bank funding. It also offers a broad range of benefits to the wider business.

Thanks to the development of technology-enabled platforms and credit-insurance solutions, these advantages can now be offered to a vastly greater pool of businesses. Those middle-market entities that are sub-investment grade can now enjoy the same benefits that the larger multinationals take for granted.

WHAT IS SCF?

Supply chain finance (SCF) is a process whereby companies give their suppliers the option to be paid early for their invoices in exchange for a discount. Once the buyer has approved an invoice, the supplier can sell that invoice to the buyer's bank. The size of the discount that the seller accepts will vary according to how soon they sell the invoice. Many businesses use the establishment of an SCF programme as a way to secure longer payment terms from their suppliers, which benefits their own cash flow. Their suppliers, meanwhile, can improve their own cash flow by claiming earlier payment.

1 *Working Capital Management and Firm Profitability: Empirical Evidence from Manufacturing and Construction Firms Listed on Nairobi Securities Exchange, Kenya, International Journal of Accounting and Taxation*, Vol 1 No 1, December 2013, D Makori and A Jagongo (2013)

2 *The determinants of working capital management, Journal of American Academy of Business, Cambridge*, Vol 10 No 1, JR Chiou, L Cheng and HW Wu (2006)

3 *The Role of Treasury in Working Capital*, FINANCE Research (2014)

Robert Barnes is founder of SCF provider PrimeRevenue

The future of pooling

NOTIONAL POOLING HAS EARNED ITS PLACE IN THE LIQUIDITY MANAGEMENT ARMOURIES OF COMPANIES AROUND THE WORLD. REGULATORY CHANGE NOW PRESENTS A CHALLENGE – BUT CHANGE CAN BE A DRIVER OF INNOVATION, ARGUE STEPHEN EVERETT AND JOHN SALTER

As Basel III comes into effect, the implications of the new regulation are becoming increasingly clear. While detailed analysis has focused on what Basel III means for corporate deposits, commentary on the impact to notional pooling has been more general.

As a solution, notional pooling is fundamentally different from cash-pooling structures, where balances are physically swept to and from a header account. In a notional pooling arrangement, credit and debit balances are notionally offset against each other – without the movement of funds – in order to 'self-fund' and reduce the cost of overdrafts across the relevant accounts.

This can be useful for treasuries that are more decentralised or prefer to avoid the co-mingling of funds associated with physical pooling structures. This is also one of the preferred solutions that is currently used for the ongoing management of balances across a number of different currencies.

While notional pooling has been available for many years, regulatory change could threaten the viability of this type of solution – at least to some extent. With some global banks reportedly now reviewing their notional pooling offerings or marketing, many corporate treasurers are rightly asking their banks what the future of pooling looks like.

In with the new

This shift has been caused by a number of different factors relating to Basel III. For one thing, under the new regulation, balances that are classified as operational are more attractive to banks, while non-operational balances are less attractive.

As a result, there is a greater incentive for banks to seek balances that are linked to their clients' core banking, such as payments and collections. Of course, this will not be uniform, since the drivers will depend on a number of factors relating to each bank's funding mix.

This has implications for a specific type of pooling structure: the liquidity overlay. Under this model, which operates as a standalone structure, the provider sweeps money from a number of different banks on behalf of a corporate, and then overlays a notional pooling solution on top. From the company's point of view, this solution achieves the desired goal of reducing funding costs without requiring a more rigorous project to centralise its treasury function.

From the bank's point of view, however, there is a lot of potentially more costly cash on the balance sheet, with little operational tie-in. This type of solution is less attractive under Basel III, and some historic providers are likely to move away from these solutions or seek ancillary business from their clients, while new entrants may see an opportunity.

The challenge in context

This issue is specific to liquidity overlay solutions, but other factors affect the viability of notional pooling more generally. In order to viably offer notional pooling, banks need to be able to report the balances in a pool on a net basis for both financial and regulatory reporting to avoid capital costs. Under Basel III, for example, banks may be permitted to report notional pooling structures to the regulator on a net basis for capital reporting, as long as the company uses a credit risk mitigation technique.

These techniques historically included joint and several liability in the UK, or a pledge in the Netherlands. The Dutch central bank, however, issued a flag note in July 2013, challenging net reporting for multiple legal entities based on historical credit risk mitigation. This raised a number of questions about how ongoing structures in the Netherlands would look. There is also concern that other European regulators could decide to follow suit.

That's not all. The most significant hurdle facing notional pooling is Basel III's leverage ratio, which aims to limit the total amount of risk that a bank can take on. Article 429 of the EU's Capital Requirements Regulation states that assets and liabilities cannot be reported on a net basis for the leverage ratio, and that credit risk mitigation cannot be used:

- "*...(b) physical or financial collateral, guarantees or credit risk mitigation purchased shall not be used to reduce exposure values of assets;*
- *(c) loans shall not be netted with deposits.*"

This stipulation may have a significant impact on the scalability of notional pooling structures. Essentially, net reporting becomes a finite resource limited by capital under the leverage ratio. While banks may already have the capital they need for their existing pools, they could find that new structures or larger netted positions will incur an additional capital cost.

Significantly, there are some differences between the European and US interpretations of Basel III. At this stage, banks in the US may have a little more leeway, since the relevant clause is less defined in the US interpretation of Basel III. Nevertheless, it is likely that there will be further harmonisation

between the US and Europe as the leverage ratio is embedded.

Implications for corporates

What does all this mean for corporate treasurers? While notional pooling may present greater challenges under Basel III, opportunities for treasurers still exist and it would be premature to believe that banks will stop offering this type of product altogether. It is clear, however, that significant challenges are emerging – and treasurers need to be aware.

The main point to note is the likelihood that notional pools may incur additional capital costs in the future, which could translate into a more limited offering from banks, or greater selectivity in terms of which clients are offered this solution. Treasurers using notional pooling will need to understand that there is an element of risk as the impact of regulation flows through, so they should engage with their banks in order to understand this point as clearly as possible, while taking a risk-based approach.

Opportunities ahead

This is not an insurmountable issue. In reality, many corporate treasurers do not use notional pooling as a standalone product. Notional pooling is often used in combination with physical sweeping, which is undertaken to move the relevant balances into a single country.

By concentrating balances in this way, into a single legal entity, such as a treasury entity, a degree of centralisation can be achieved, thereby reducing the complexity of any notional pooling and associated risk – meaning that, if the notional pooling element has to be reduced or settled more regularly, the company will still retain some of the benefits of automated pooling.

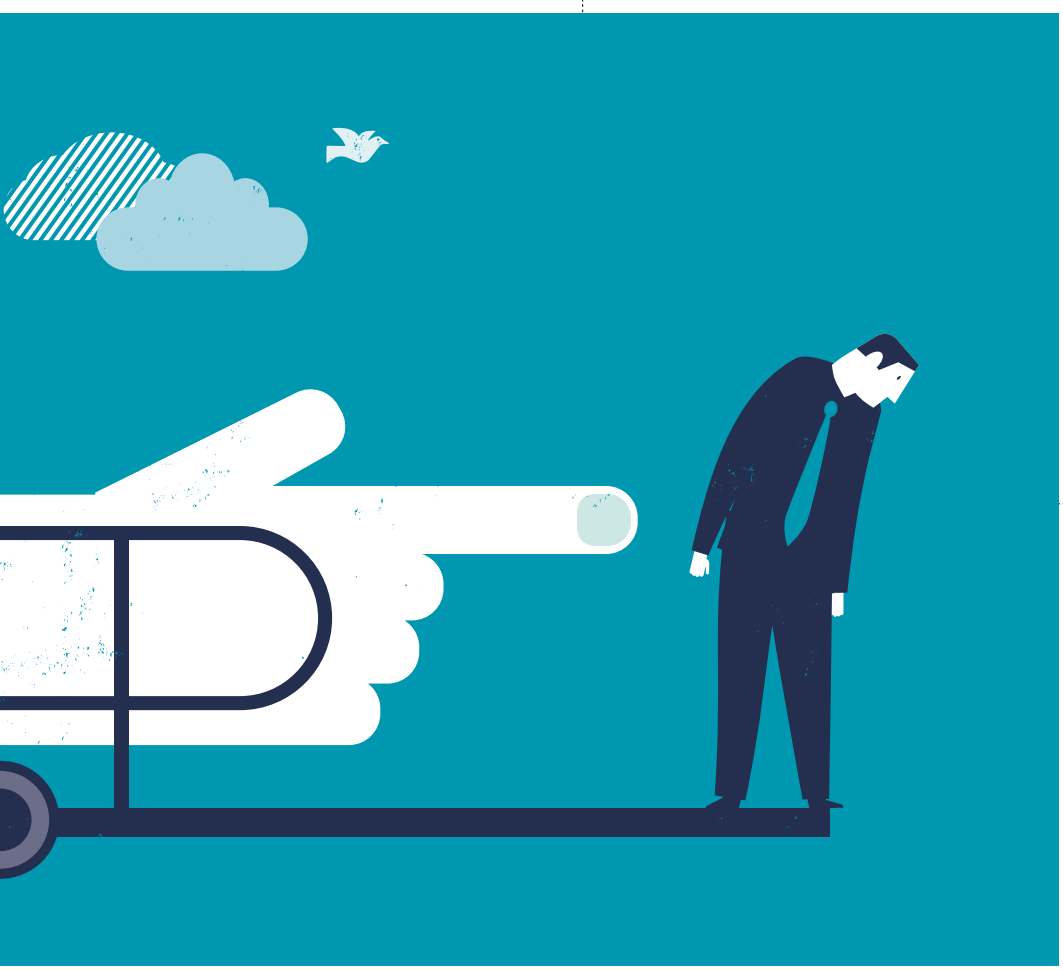
Furthermore, these developments may have a very positive impact on companies looking to move to a more centralised structure. The question mark over this solution could help such companies to build a business case for the greater centralisation of their cash and treasury policies, which could lead to further long-term benefits in efficiency and control.

At the same time, with the high level of competition and investment in this space, it is likely that banks will step up innovation in liquidity management, leading to new opportunities in areas such as cross-currency sweeping and multi-currency accounts, as alternative or complementary solutions for multi-currency notional pooling. Payments and receivables 'on behalf of' structures in the Single Euro Payments Area can also simplify liquidity structures, reducing cash pooling altogether. Change drives innovation, in this sector as in any other, and the results are often incredibly positive.

What now?

For treasurers currently using notional pooling – or considering using notional pooling – the most important next step is to work closely with existing and prospective banks in order to understand the nature of these challenges and their bank's response as regulation evolves. In this way, they can incorporate any risks into solution or treasury planning, and remain on the front foot.

As some banks adjust their markets and offerings, a number of companies are likely to be exploring liquidity management solutions with new banks. Treasurers in this position should avoid the temptation to replicate solutions they have had in the past: the landscape is fundamentally changing, and it is important to gain an accurate understanding of these issues in order to make an informed choice, and tap into innovation in this area as it continues to evolve.



Stephen Everett (left) is MD client proposition, global transaction banking, and John Salter (right) is MD global corporate and financial institutions, global transaction banking, at Lloyds Bank Commercial Banking

LLOYDS BANK

Bring on the basket

HOW DOES SHELL MAXIMISE THE POTENTIAL OF COLLATERAL THROUGH TRI-PARTY REPOS? CHARLIE BEDFORD-FORDE EXPLAINS

Ongoing debt problems in Greece and other European nations are a constant reminder that risk has not gone away, and this market uncertainty is motivating prudent corporate treasurers to hang on to their cash.

The overall liquidity pool in the corporate sector right now is very deep. Gross cash and cash equivalents held by 672 companies in Europe, the Middle East and Africa rated by Moody's, amounted to $1.06 trillion at the end of 2014, according to a *Financial Times* report in July. And with some banks even charging corporate clients for depositing cash, investing securely while gaining some additional spread is becoming increasingly challenging.

Oil is one sector that traditionally sees large cash concentration. At the end of Q1 2015, the Shell Group reported balance-sheet cash of $20bn, with a cash flow from operating activities of $7.1bn. It's no wonder, then, that Shell has a diverse cash-investment portfolio that takes advantage of centralising its cash in London with the support of regional centres in Singapore and Rio de Janeiro.

One important and well-used product in Shell's cash investment suite has been tri-party repurchase agreements (repos), reports Frances Hinden, VP of treasury operations at Shell International.

Shell signed its first tri-party repo agreement in 1997, but it only began using the tool seriously around 10 years ago, after a new front-office recruit from the Bank of England asked why the company was not investing in repos. Back then, many processes were still manual and concerns about operational risk prevented Shell from investing much in repos.

A new master agreement

"We didn't do much back then, but we did set it all up," says Hinden. "We had to agree GMRAs [global master repurchase agreements] with each counterparty individually, and there are still scars on some of our legal team because one of the GMRAs took five years to complete."

The GMRA has been the industry-standard international contract for more than two decades and it has to be agreed bilaterally between each pair of counterparties. But horror stories, as experienced by Shell, have earned it the reputation for being sometimes difficult and expensive to negotiate.

Seeing that this was becoming a barrier to entry for some corporate treasurers led Clearstream to develop an easy-access, standardised master agreement – the Clearstream Repurchase Conditions (CRC) – to help its clients to enter the tri-party repo market. Unlike the bilateral GMRA, the CRC is multilateral, so a repo participant only has to sign one document and is then able to trade with any other counterparties within the CRC community.

"My advice to other treasurers is not to do what we did and enter into a GMRA, but to use the standardised CRC with everyone," says Hinden. "The really painful part of this was negotiating the GMRA and, if you can avoid that, then it would make the whole set-up so much simpler."

Having endured the pain means that Shell now has what Hinden calls a "bullet-proof GMRA", and tried-and-tested collateral eligibility criteria that are implemented with every new banking counterparty.

A simpler approach

The Shell treasury team collaborated closely with Clearstream and Bloomberg to overcome the operational risks intrinsic to largely manual processes.

"We said what we would like to see and then Bloomberg set up new functionality and Clearstream set up the connectivity to the functionality," explains Hinden. "And that means we now have a much simpler approach: there's an online quote facility and we agree everything with the counterparty online via Instant Bloomberg (a chat tool).

"Typically, we agree one to two days before the investment and they confirm. The deal is then processed automatically straight through from Bloomberg to Clearstream. The only thing our team has to do separately is move the cash."

This high level of automation and the fact that the administration, collateral allocation, substitution and margin management is carried out by a tri-party agent (Clearstream) has encouraged Shell to use repos as a regular part of its investment strategy. In particular, Hinden is happy that Shell has an agreed basket of acceptable collateral in return for the cash.

"It is a very simple statement that says: 'This is what we accept. This is what the haircuts are'," she explains. "Then we ask the banks to quote on the basis of our basket."

Shell usually invests in repos from seven up to 90 days, while its overnight liquidity is still mainly in money market funds (MMFs). In accordance with its risk policy, the Shell treasury team chooses to accept only high-quality securities as collateral. This makes the repo very safe and yet still able to pick up a reasonable yield.

COLLATERAL DOUBLE DIP

Shell has recently extended its repo strategy – it now reuses the securities received as collateral in fulfilment of exchange margin requirements for commodity trades.

"This is a way to get a 'double dip' on those securities," explains Frances Hinden, VP of treasury operations at Shell International. "In Shell's treasury, we have spare cash, while our colleagues who do commodity trading have margin requirements at the trading exchanges that they can satisfy using high-quality collateral or cash. They cannot get a return on the cash – and, in fact, they are even charged for depositing it.

"So the Shell Group is much better off if we use our cash at the bank in a repo, receive the collateral and return on that cash, and then use that collateral to satisfy margin requirements."

Formalising the transfer arrangements, and solving legal and risk concerns between treasury, the exchange and separate Shell trading companies took time to set up.

"The idea of this was simple, but the implementation took a good year of legal discussions," says Hinden. "But eventually everyone signed up and now we are live."

With this strategy, Shell is well prepared for the new regulations that push all derivative trades through clearing houses, thereby increasing margin requirements.

"Cash positions will be more volatile when derivative agreements are collateralised, as we will have to satisfy both initial and variation margin," says Hinden. "So we will need to keep short-term cash and we will continue to invest in repos."

For an interview with Ian Chisholm, VP financial markets at Shell, see page 22

What's not to like?

"It is common in the market to get higher yields on repos than on straight bank deposits and MMFs," says Hinden. "But, of course, getting a higher yield with less risk is not logical from a theoretical point of view."

Confounding the normal risk-return curve was down to regulatory arbitrage, she explains. "The banks have high-quality liquid assets and they need to make use of them, while still maintaining a certain level of those securities in order to fulfil their capital requirements. Repos make sense for banks, as they actually don't like taking short-term deposits because that penalises them in terms of the amount of capital they have to hold."

Effectively, the upshot of this regulatory arbitrage is that buyside institutions investing in repos gain increased yields and security.

"What's not to like?" asks Hinden.

At the moment, Shell's treasury has a large amount of cash on its balance sheet. This is partly the result of a recent debt issuance.

"In the short term, we have a large cash position we need to manage, and tri-party repo is certainly a very good and secure use of our cash," says Hinden.

"One challenge we face is that a number of banks have been downgraded, making it harder to find a good home for the cash in line with our counterparty limits. Repos help in this situation."

Charlie Bedford-Forde is VP global securities financing, UK, Ireland and the Americas, at Clearstream. For more information, see www.clearstream.com or email gsf@clearstream.com

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Chasing payments

THE NUMBER OF DEBTORS IS CONSTANTLY GROWING AND SO IS THE NUMBER OF BAD DEBT LOSSES SUFFERED BY COMPANIES. WHY DON'T BUSINESSES SETTLE THEIR BILLS ON TIME? MAŁGORZATA WEJER EXPLAINS

Since 1989, fundamental changes have revolutionised the economic, political, legal and social systems in Central and Eastern Europe, and the former Soviet Union countries.

One of the advantages to these countries of entering a free market was that their companies were able to do business transactions without having to make immediate payment. But these new market rules, which were introduced in the emerging countries, caused several problems, including the onset of overdue payments.

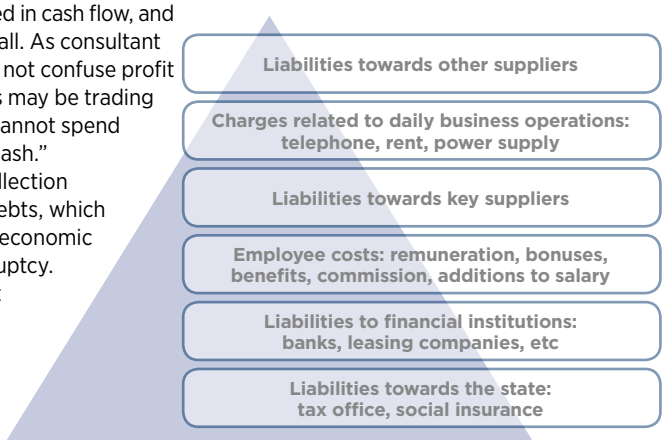
In Poland, around 43% of all business transactions are currently made on credit, out of which 30% are overdue. In other Eastern European countries, the proportion of uncollectible debts is 32%, whereas for Western countries it is 37.6%. From east to west, the most frequent reasons for not paying on time are insufficient availability of funds and the use of invoices as a form of financing.

Many companies that have failed recently would have looked very prosperous if just their sales value and turnover were taken into account. Yet, the profits resulting from an increase in receivables were not reflected in cash flow, and this presents a lesson to us all. As consultant Charley Swords puts it: "Do not confuse profit with cash – while a business may be trading profitably, remember, you cannot spend profit, you can only spend cash."

Failure to initiate debt-collection procedures results in bad debts, which can plunge companies into economic crisis and, ultimately, bankruptcy. Entrepreneurs are often not aware of the consequences of outstanding payments, which include the cost of lost opportunities, debt-collection costs and costs remitted to the state treasury for every transaction. Shorter recovery time guarantees smaller losses for the company. When a company is in financial difficulty, every day of a delay in recovering receivables can play a decisive part in determining whether the business continues or not.

Currently, almost all business-to-business transactions are made on credit, with terms of payment varying. Yet the reasons for overdue receivables are nearly the same in every business sector. One of the major reasons for this is that a company's source of funds is limited, which forces it to prioritise its payables. If the company does not have enough money, it starts to choose among its suppliers, beginning with the strategic ones. If a company is short of resources for day-to-day payments, this may be a result of its chosen order of settling liabilities, which could follow the pattern shown below.

First, companies make payments to the state authorities, which, in the case of late payments, charge penalty interest and quickly initiate recovery procedures. Debtors are afraid of the state institutions, so they have a considerable predominance over others.



Next, there are those payables to financial institutions, mainly banks and leasing companies, that are related to operating activities and allow the entrepreneur to realise key company objectives. Again, the business cannot afford any stops in production or delivery service because of the consequences of overdue payments: the institutions may cancel the contract immediately.

Employee benefits, liabilities to strategic suppliers and payables for day-to-day operations

HOW TO MANAGE LATE PAYMENTS

1. **MAKE IMMEDIATE CONTACT** with the debtor to ask when the overdue payment can be expected. Send the final notice outlining all the payment details. Remember that time is king, especially in debt collection, since research conducted in EU countries has shown that where a payment is three months overdue, the chances of recovering the receivable are 75%. This drops to 50% after six months and 25% after one year.
2. **WITHHOLD THE DELIVERY** until the payment is received. Get everyone involved. Overdue receivables are not just an issue for financial managers; sales managers can be very effective in terms of collecting debts and stopping the debtors' purchases.
3. **COMMENCE LEGAL ACTION.** Invest in a good legal adviser to help you to investigate your receivables in the court and to commence execution proceedings.
4. **WRITE OFF THE DEBT.** The company may write off the receivables on the basis of probability of recovery in certain circumstances, such as:
   - *receivables from debtors who are in bankruptcy or in the midst of a liquidation process;*
   - *receivables from debtors whose request for bankruptcy was dismissed by the court;*
   - *questioning of receivables by debtors; and*
   - *due or overdue receivables for which recovery is very doubtful.*

are ranked third and fourth on the list because late payments bring no severe consequences. In the case of payments to staff, some employers will assume that people can wait.

Fifth come payables to suppliers of the basic services needed to run a business, for example, gas, energy and telephone providers. One of the reasons why these providers rank fairly low on the list may be the fact they apply ineffective collection procedures.

Last in line are liabilities to suppliers, whose trade credit helps businesses to finance themselves without incurring penalty interest for a delay. So, if your company is not a strategic supplier and does not represent a state organisation, you have to be prepared to wait for payment for a long time. Ironically, the fact that this situation is allowed to exist is probably a result of many entrepreneurs having effective debt-collecting procedures.

While the problem with uncollectable debts applies across Europe, the reasons why companies do not pay differ from west to east. I have chosen one country – Poland – to juxtapose the average results in Europe with those of an exact country.

According to the results (see above), the most frequent reason for delayed payment was insufficient availability of funds. Polish respondents also blamed complexity of the payment, as well as inefficiencies of the banking system, which the other European respondents did not concur with to the same degree. The other worrying reason for overdue payments was the inaccuracy of the information put on the invoice. This simple matter is a typical problem for Polish businesses. It is worth mentioning that a significant proportion of Polish market players use trade credit as a way of financing their businesses. This suggests that overdue payables are a practice commonly used by Polish entrepreneurs.

MAIN REASONS FOR PAYMENT DELAYS BY DOMESTIC BUSINESS-TO-BUSINESS CUSTOMERS

	Eastern Europe	Western Europe	Poland
Insufficient availability of funds	58.6%	46.6%	51.2%
Dispute over quality of goods delivered or service provided	11.1%	16.7%	8.0%
Goods delivered or service provided do not correspond to what was agreed in the contract	9.5%	13.2%	12.9%
Complexity of the payment procedure	11.3%	18.0%	19.9%
Inefficiencies of the banking system	10.4%	17.8%	23.4%
Incorrect information on invoice	11.5%	16.2%	18.4%
Buyer using outstanding debts/invoice as a form of financing	30.0%	29.3%	35.3%
Formal insolvency of the buyer (liquidation, receivership, bankruptcy)	25.0%	20.5%	29.4%
Invoice was sent to wrong person	8.2%	12.7%	11.0%
Other	10.5%	6.7%	2.5%

Source: Atradius Payment Practices Barometer – June 2014

Better late than never

In order to minimise the level of overdue receivables that they have, companies could monitor all of their payments on a regular basis.

The perfect tool to help managers control the outstanding accounts is an ageing schedule that presents a company's invoices and its due dates, usually in a table format. Another method is checking days' sales outstanding, which gives an approximation of the average age of accounts receivables. These techniques inform managers of the current financial standing of the company, so they can promptly initiate its debt-collection procedure.

Once this procedure is initiated, the first step would be to investigate why the customer did not make the payment and check when this overdue payment can be expected. All employees involved in the business transactions should know that deliveries to that debtor will be withheld until the payment is received.

It is paramount that the business's legal adviser be engaged at this stage. If there is no possibility of collecting the receivables, then the accountant should write off the debt, allowing the creditor to adjust previously accrued tax.

Conclusion

The above-mentioned reasons for not paying on time should serve as a warning against the growing number of overdue receivables. The perfect solution for businesses would be to avoid overdue receivables altogether, but this is almost impossible. If your business struggles with an increasing number of bad debts, then all of your actions should lead in one direction: effective and immediate debt collection.

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A 360-degree view

TO SUCCEED IN OUR FAST-MOVING BUSINESS ENVIRONMENT, ORGANISATIONS NEED TO HAVE COMPLETE REAL-TIME VISIBILITY OF THEIR OPERATIONAL CASH MANAGEMENT POSITIONS, SAYS PAUL ORMROD

Economic growth is providing a catalyst for increased business specialisation, cross-border expansion and outsourcing. The knock-on effect is an explosion in the volume of payment transactions that businesses manage. This is placing pressure on working capital, as the expansion costs for businesses are often front-loaded. Regulation is also more invasive, while service level and supply agreements are increasingly tight around control of transactions, requiring traceability and speed.

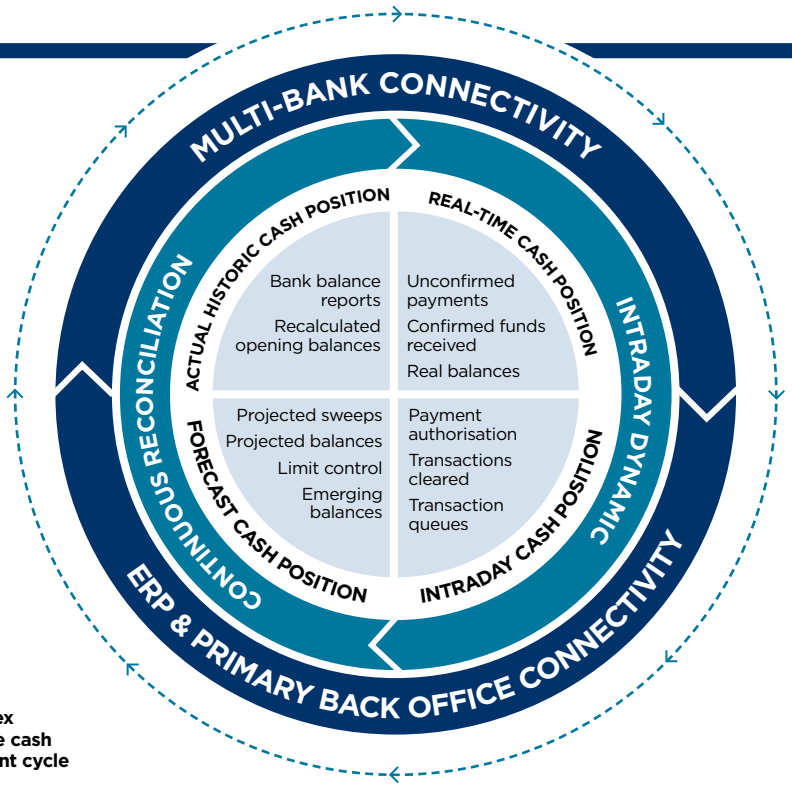
Real-time pressures

The dynamic nature of managing operational cash processes in this new business environment means that organisations must have the ability to continuously reconcile monetary flows, with their treasurer being able to understand the organisation's intraday dynamic cash position.

He or she must be able to readily change the forecast cash position of the organisation as granular events that impact the business happen. They must also be able to reconcile the wider, longer-term cash flow forecast with the nearer-term events on the ground. Did what we expect happen at the transaction level? Did it happen yesterday, or is it still outstanding? Do I need to change my forecast and management of balances? These are questions where the answer still eludes many treasury functions.

Treasury professionals are constrained by the lack of real-time visibility across their entire organisation, particularly when it comes to multi-currency and multi-jurisdictional cash flows. This is highly problematic.

Taking a 360-degree view of cash is necessary for organisations to understand their operational cash management positions with full accuracy. To do this, they must reconcile intraday visibility in four main areas:



The complex 360-degree cash management cycle

Source: Cashfac Technologies

- Actual historical cash position (including bank balance reports and recalculated opening balances)
- Real-time cash position (including unconfirmed payments, confirmed funds received and real balances)
- Intraday cash position (including payment authorisation, transactions cleared and transactions queued)
- Forecast cash position (including projected sweeps, projected balances, limit control and emerging balances)

Treasury invading the banking space

Often, corporate payment processes use separate technologies to forecast cash flows and make payments. As a result, operational cash management is riddled with disconnects, from order management, delivery and invoice processes to payment requisition and aggregation. Organisations are also managing multi-bank relationships, lengthy account opening processes and the need to appropriately manage client monies and comply with regulation.

It is little wonder that cash flow forecasts lack precision and take so much time to reconcile and restate. Such predictions, including near-term ones, are approximations based on many variables including expected balances, payments and receivables, changes in business levels and supply chains. But they can be more precise if treasurers invade the banking space.

In assuming that payments (and receipts) start with an instruction to the bank, banking processes often mirror the disconnects found in operational cash management processes.

The origin of any payment will lie in an order or invoice, payroll or continuing contract. These represent forward cash payments that firm up on delivery and authorisation, and can be created weeks before a payment or receipt. A cash flow forecast based on forward cash payments provides a more granular, integrated and precise method.

The long-term cash flow forecast remains the same in its construction, but the daily, weekly and even monthly partitions in that forecast give way to the granular, forward cash translation of orders and invoices. As the forward cash items translate into payments and receipts, so the forecast automatically changes.

For this to work, there must be continuous reconciliation: externally to banks and internally to client and supplier accounts, and a suite of reconciliation tools for matching and allocation against expectations. Self-learning matching will drive higher match rates and real-time visibility of payables and receivables, to enable full transparency of cash processing.

Power in the hands of corporates

Intraday data feeds from the bank are important, but they are no substitute for information that can be accessed in real time. A real-time cash book can supplement the cash flow forecast in its anticipation of transaction clearing and, with the right technology, including continuous balance re-striking, can reduce the dependence on the quality and frequency of intraday feeds. This puts power in the hands of the corporate and enables information to be accessed when needed, rather than when a bank can provide it.

From a bank account perspective, the cash book provides a record of the corporate bank account and becomes the operating view. This can be extended across tens, hundreds or thousands of accounts, which, when automated, increases transparency and reduces workload.

Thus, the treasurer has invaded the banking space. They can confront daily transaction volumes and peaks, multiple bank connections, multiple bank accounts and hundreds of client accounts and supplier cash accounts.

Treasury tools are available for sweeping, target balancing and pooling. These enable enterprise resource planning-connected cash-flow forecasting based on balances, future payments and expected payments and receipts. They also allow flexible interest-rate management so that firms can arbitrage interest by controlling rates applied to virtual accounts and withholding tax management.

By representing orders and invoices as forward payments and receipts, most of the information needed for matching to incoming receipts, as well as for generating payments, is made available. As bank data is imported, these items are matched, become executed bank transactions, and drop out of the forward view. The continuous matching and reconciliation processes used to achieve this are in real time and inside the operational workflow.

Here is the close of the 360-degree cash management cycle. Not only has the treasurer invaded the banking space but, by combining the forward payments into the real-time view of the bank accounts, they have fully integrated bank accounts into the corporate workflow and cash flow projections.

These processes continuously adjust the forward view of the end-of-day balance. By the same process the following day – and beyond – balances are automatically updated. The treasury screen is replaced with a real-time view of the bank account that shows the transactions and balances and, with increasing accuracy, what the balance will be.

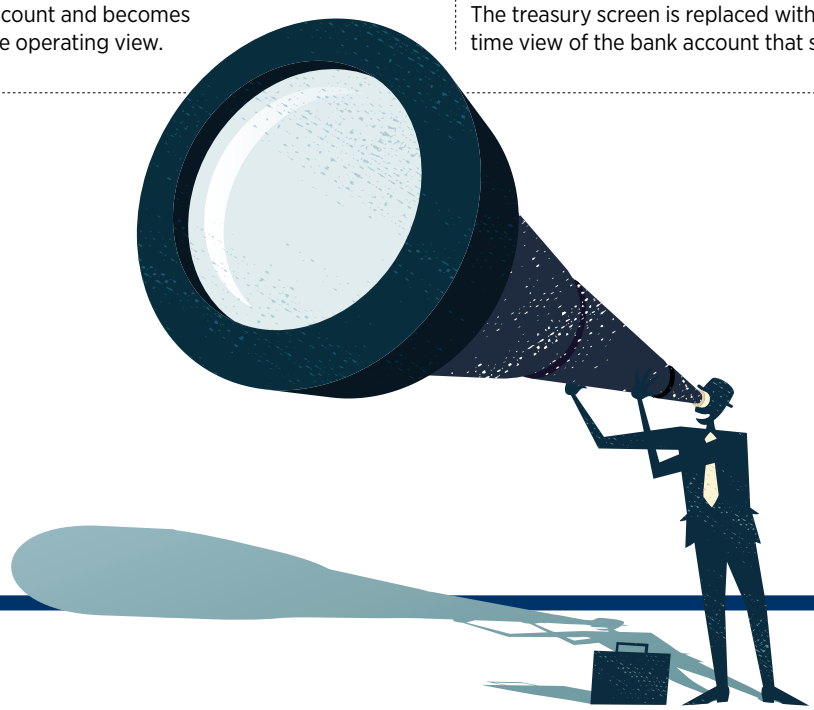
This means real-time reporting and management information systems using dynamic dashboards that show statements 24/7 on real and virtual accounts, and offer industry-specific regulatory, as well as operational, cash flow and reconciliation reporting.

A 360-degree view of cash management opens up opportunities in non-bank financial services. For example, where firms can see and verify their real-time balances, they are able to assess whether the balances are sufficient to fund business; clients can pay into their client accounts without invoking manual processes.

On the supplier side, if a cash management system operates supplier accounts that show forward payments before they are aggregated into single payments, and supplier access to this account includes download to ledgers, the cost of processing receipts will decrease as the payment content is pre-reconciled. If forward payments, both soft and firmed-up, are included, suppliers can help ensure precision in forward payments and cash management.

Ultimately, to better manage operational cash, corporations must view and take action at any point in the 360-degree cash lifecycle. Integration of multi-bank relationships and internal cash management systems needs to be seamless and aligned to core business operations. For banks supplying corporate cash management services, this represents a significant challenge and a great opportunity.

Technology can facilitate and support banks in providing customer-centric, self-service cash management solutions, cutting the time to market, reducing the cost of account management and driving greater value from customer transactions.



Paul Ormrod is founder of Cashfac Technologies

CASHFAC TECHNOLOGIES

LIQUIDITY IN LATIN AMERICA

COMPANIES OPERATING IN THIS UNPREDICTABLE REGION HAVE A WIDE RANGE OF STRATEGIES THAT CAN HELP THEM TO REDUCE RISK AND MAKE OPTIMAL USE OF THEIR CASH, WRITES ODETTE IZQUIERDO

Slowing economic growth and increased FX volatility in many Latin American countries are prompting companies with operations in the region to seek to better manage their risk and improve their efficiency.

While Latin America has a reputation – deserved in some instances – for high levels of regulation, there are opportunities to manage FX and other risks effectively and to improve operational and liquidity management efficiency. Below are four key ways in which corporate treasurers can achieve their liquidity management objectives against an evolving economic and regulatory backdrop.

1. Rationalise bank relationships and bank accounts

In the years since the 2008 financial crisis, many companies have re-evaluated their banking relationships. Historically, companies in Latin America have tended to accumulate additional banks as they entered new markets (either organically or through M&A). This makes it difficult to mobilise funds and results in fragmented visibility and information, connectivity challenges, problems with reconciliation, and multiple points of contact for relationship and customer service.

Moreover, corporates' processes for selecting banks have seldom been rigorous. Often, if a bank with which a corporate has an existing relationship has operations in a country where the company needed a partner, that bank was simply mandated.

The shock of the financial crisis, and the weakness of many banks in the years that followed, means that treasurers are now intently focused on the credit quality of their company's partner banks. The introduction of the Basel III regulatory framework, which increases the amount of capital that banks must hold, and the US Federal Reserve's Comprehensive Capital Analysis and Review, which evaluates the capital-planning processes and capital adequacy of the largest US-based bank-holding companies, have further highlighted differences between banks in terms of financial strength.

Corporates have responded by rationalising the banks that they work with, usually by selecting a single regional partner bank and then choosing a local partner bank in markets where additional services are required (such as cash collection or employee services, for example). By working with a single regional partner bank, it is easier to automatically concentrate funds, centralise visibility (including through integration with enterprise resource planning systems) and standardise payment processes (potentially opening up the possibility of centralisation of payments in the future).

Bank relationship consolidation (as well as bank account rationalisation) might also help to reduce fees and streamline funding and control of multiple accounts. Partner banks and clients can work together to achieve benefits for all parties. Clients can leverage their regional/global relationships to increase their bargaining power, while banks can take advantage of opportunities in markets where liquidity is needed.

Fortunately, the drive by companies to concentrate their banking activity with a smaller group of banks comes at the same time as regulatory change. Most obviously, Basel III's liquidity coverage ratio (LCR) is encouraging banks to focus more on client selection and increasing the range of business they do with their chosen clients. The LCR distinguishes between different types of client assets in terms of capital requirements: overall, it encourages banks to seek corporates' operational deposits (ie those that are linked to specific operational services), while making short-term excess relatively unattractive for banks. Latin American clients have to evaluate their short-term investment policies in order to enhance returns in this new environment, especially given the backdrop of slowing growth. It is therefore advantageous for both banks and corporates to optimise the 'share of wallet' that is allocated to a bank.

2. Use regional treasury centres

Companies across Latin America increasingly want to aggregate regional balances and automate cash mobilisation so that operational risk – and frictional cash – are reduced. Ideally, companies would like to sweep credit and debit balances from source accounts into a nominated header account to achieve pre-specified targeted balances in all source accounts (often zero) on a regular basis. This way, liquidity can be optimised and surplus funds can be effectively invested.

Self-funding between entities within the same group also considerably reduces interest and overdraft costs. In addition,

> In the years since the 2008 financial crisis, many companies have re-evaluated their banking relationships

SAUL GRAVY/GETTY IMAGES

a regional treasury centre can take responsibility for FX management and other functions (including intercompany loans, for example).

Yet the diverse (and often restrictive) regulatory environment in Latin America, where each country has different rules and requirements, makes it challenging to implement a single regional treasury centre for liquidity management.

Instead, corporates are increasingly establishing treasury centres that serve a cluster of markets, such as Peru, Chile and Uruguay, which have common characteristics or the necessary tax treaties to facilitate effective liquidity management. Similarly, economies with high levels of regulation can be clustered, with flexible investment policies implemented to overcome high inflation risks, for example. This pragmatic approach to liquidity management takes into account the challenges and restrictions that exist in the region, but still enables companies to achieve their broader regional treasury objectives and optimise efficiency. It also leaves open the possibility for further regional consolidation of treasury activities as regulations change.

Regional knowledge should be combined with a global perspective

3. Manage cash efficiently

FX and other regulations in some Latin American countries, such as Argentina and Venezuela, can make it difficult to move money easily; while in other countries, such as Brazil and Colombia, it is impossible to move money automatically. These restrictions make liquidity management challenging. Moreover, notional pooling, which offsets debit and credit balances in different locations, is infrequent within Latin America.

While intercompany loans could create tax implications, some corporates find that these are outweighed by the economic benefits from managing intra-affiliate group cash flow and reducing reliance on costly bank funding. Banks are constantly evolving their infrastructure to provide complex solutions that can help multinational corporates to manage arm's-length pricing and thin capitalisation rules, depending upon the jurisdiction of each participating affiliate.

Other possible solutions include re-invoicing, which is often managed from a centre in Panama, Uruguay or Europe. Companies implementing re-invoicing solutions in order to centrally and efficiently manage their commercial flows within the region (ie to improve operating efficiency) have found that re-invoicing can enable them to achieve cash optimisation benefits, even in restricted markets.

For example, a corporate's commercial unit may purchase final goods from a manufacturing unit and manage the final sale to the end buyer, either a third-party customer or a division within the company. These transactions are carried out in the affiliate's local currency and therefore the commercial unit absorbs the FX exposure (in accordance with local transfer pricing rules). The group benefits from centralised management of intracompany flows and better forecasting of liquidity and FX exposure. Cash-rich companies use this contract-manufacturing model (which is in accordance with local transfer pricing rules) to reduce the reliance of local affiliates on market funding.

4. Manage FX risk

Corporates are eager to manage FX volatility, which has increased for some Latin American currencies in the past year as the economic outlook has deteriorated. Hedging could be one option, but it can be costly and many companies are taking a broader look at their operations and treasury in order to enable them to manage FX risks more holistically.

One option is to align receivables and payments in the same currency so that the company creates a natural hedge; another is to use US dollars, when possible, as a functional currency. Alternatively, forecasting can be improved so that FX exposures at a local level can be matched at a global level, eliminating the need to use the spot market.

Another possibility is the use of working capital financing loans, which have the potential to significantly limit the FX risk that results from issuing a local currency purchase order when costs are in US dollars. For example, where a US manufacturer exports to Latin America, the local commercial unit would take a loan (in local currency) to cover the purchase order, and then convert it to US dollars to pay back the US parent. While this entails a borrowing cost for the local entity, in markets where currencies have fluctuated in value by 5-10%, these costs may be worthwhile.

The right partner

The uncertain economic environment in Latin America is increasing the need for companies to effectively manage their risks. Latin America remains complex in terms of FX and other regulations that impact liquidity management. Yet solutions are available to meet many of the challenges facing companies that operate in the region.

For companies to achieve their liquidity-management goals in Latin America, they need to work with a bank that has solid experience and deep knowledge of local and regional conditions. Firms need a regional partner that places Latin America at the heart of its strategy, particularly as some global and multi-regional banks are scaling back their activity in the region.

Regional knowledge should be combined with a global perspective and market-leading solutions. This way, multinationals – and multi-Latinas (firms that start in one Latin American country and spread throughout the region) – can ensure that their treasury is as efficient as possible and that they can leverage structures, such as regional treasury and re-invoicing centres, and implement strategies to effectively manage market risk, while ensuring optimal standardisation, visibility and cash forecasting.

Odette Izquierdo is head of liquidity management, Latin America, at Citi

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EASE OF EXCHANGE

WHILE DIGITISATION OF TRADE FINANCE OFFERS MANY BENEFITS, TAKE-UP HAS BEEN HINDERED BY THE NEED FOR ALL PARTIES IN A TRANSACTION TO 'BUY INTO' THE CONCEPT, EXPLAINS PAUL GOLDEN

Trade finance digitisation was never likely to be a 'big bang' phenomenon. This view was confirmed by a poll conducted at financial services forum Sibos late last year, where two-thirds of attendees suggested that it would be between four and 10 years before most trade was conducted digitally.

This modest rate of progress is considered unfortunate by observers such as Peter Wong, founding chairman of the International Association of CFOs and Corporate Treasurers China, and associate director of PwC corporate treasury consulting.

He believes that digital trade finance is a good option for treasurers looking to drive down the cost per unit of transacted revenue. "Increased transparency of receipt and payment flow information can result in improved cash forecasting, streamlined credit collection efforts and more efficient deployment of working capital," he says. "Digital trade finance can be an enabler for entry into e-commerce."

Yet, according to Rahul Magan, an India-based treasury manager for business process solutions company EXL, there are valid reasons why uptake has been slow. He says that digital trade finance is really only possible for organisations that already have a solid digital platform in place, as well as a legal entity set up in a major financial centre, such as Frankfurt, London, New York or Singapore, where currently the best banking infrastructure exists.

Magan also points out that trade finance digitisation is much more likely to happen when all three offices of a treasury function – the front office, the middle office and the back office – are on the cloud. In practice, however, it is rare for a corporate to have all three offices on the cloud. Finally, treasurers' risk management policies are often not up to date with current digital standards.

Digital trade finance

Digitisation allows corporates to achieve better control of their credit facilities, reduce fees and speed up the application process, enabling them to grow transaction volumes without the requirement for additional credit.

For export letters of credit, faster document preparation and reduction of errors allows exporters to offer better pricing. Buyers can also claim the goods earlier when the exporter sends the original paper documents directly to the issuing bank, while providing electronic copies to the domestic bank, explains Nick Pachnev, chief

technology officer of trade finance software company GlobalTrade Corporation.

Chris Bozek, global head of trade and supply chain products at Bank of America Merrill Lynch, refers to digitisation of trade documents as a means to an end. Depending on the client's objective, options include full end-to-end digital trade with multi-bank providers, or partial end-to-end digitisation within an existing platform, he explains.

"Companies that are best placed to benefit are those with large transaction volumes and generally higher-ticket transactions operating in a narrow industry vertical with a concentrated group of buyers/sellers and counterparty banks," says Bozek. "There has been relatively higher take-up in the commodities industry by both producers and trading companies, digitising both documentary and open account trading. Over time, other industries with similar characteristics will follow."

Henry Balani, head of innovation at payment services firm Accuity, concurs with this view. "We have noticed increasing usage among chemical manufacturers and mining companies, for example, where shipments tend to be in large quantities due to economies of scale," he says. "The commercial benefits can be significant once communication and document standards are agreed to."

Magan highlights speed as an important benefit of digital trade finance. "Today, the G7 currencies are getting extremely volatile and you can't keep your currency exposures open until the banks give the go-ahead," he says. "Paper-denominated trade finance sometimes takes weeks to get approval from banks. If you use digital trade finance, you could save millions and contribute to the profit and loss, provided you have the appropriate treasury infrastructure, a presence in certain specific markets, an updated corporate risk management policy and a skilled treasury team."

AUTOMATED TRADE FINANCE IN PRACTICE

In April, a bank payment obligation (BPO) transaction for an iron ore shipment from Australia to China was completed, involving food-processing company Cargill and mining company BHP Billiton as buyer and seller respectively, with ANZ bank as obligor bank and Westpac as recipient bank. The transaction was the first time that BPO had been coupled with an electronic bill of lading and commercial invoices through the essDOCS platform, an automated trade solutions provider.

By combining electronic bills of lading with the BPO transaction, original data and supporting documents can be submitted as trade data to be matched against the payment terms. Additionally, the release of original documents to the buyer upon data match can be automated.

Digital trade finance processes accelerate bank practices, for example, by bypassing the bank's front office to go directly to the back office for review and so forth, saving hours and possibly days in comparison to paper processes, says Ashley Skaanild, head of trade finance at essDOCS.

"It also enables banks to centralise their processes," Skaanild continues. "Discrepancy management is simplified and can be done instantly, electronically, while banks can start offering the electronic letter of credit again. There is real added value for an exporter that can receive payment days or even weeks earlier than in a paper scenario."

Digitisation allows corporates to achieve better control of their credit facilities, reduce fees and speed up the application process, enabling transaction volume growth

Banking on trade finance

While the benefits of digital trade finance are evident, it can be time-consuming to on-board all parties for each transaction. There are also implications for banks, which must ensure that the client remains fully protected with regard to information security, the transmission of accurate transaction data, the processing of data in a timely manner, and compliance with relevant laws and regulations.

According to Adrian Katz, CEO of accounts receivable securitisation provider Finacity, some banks are more proactive than others when it comes to meeting the challenge of trade finance digitisation. "For example, banks that have chosen to participate in SWIFT's Trade Services Utility and the ISO 20022 standards are stepping up. Sellers are also making huge strides by using standards such as the International Organization for Standardization (ISO), electronic data interchange and the Accredited Standards Committee X9 financial standards."

Meanwhile, electronic presentation will require new processes to be put in place around the technology, comments Ian Kerr, CEO of trade chain software provider Bolero International. These processes will need to be explicitly approved by all stakeholders within a bank – including legal, accounting, finance, treasury and compliance – to ensure that the process outputs feed into its internal reporting and operating structures.

What's next?

In addition to reducing documentation errors, digitisation increases the availability of financing liquidity, since funds can be disbursed quicker upon electronic presentation of the required documents, allowing for improvements in cash management.

But Balani notes that centralising the way in which trades are cleared could lead to further improvements. "While trade transactions are typically shorter in length (three months on average) compared with other financial transactions, there is an opportunity to improve the settlement times independent of the physical movement of goods. This increased liquidity and early receipt of funds by the seller is attractive to corporates."

It is unclear, however, how quickly any progress will unfold. Hari Janakiraman, head of global core trade products at ANZ bank, is frank about the challenges facing trade finance digitisation. He says: "Trade finance transactions involve multiple parties, such as shipping companies, chambers of commerce, insurers, customs authorities and inspection companies, all of whom must also move to electronic documentation and channels." So while this process has undoubtedly begun, it would appear that ubiquitous trade finance digitisation remains a work in progress.

Paul Golden is a freelance journalist who specialises in writing about finance

A global issue

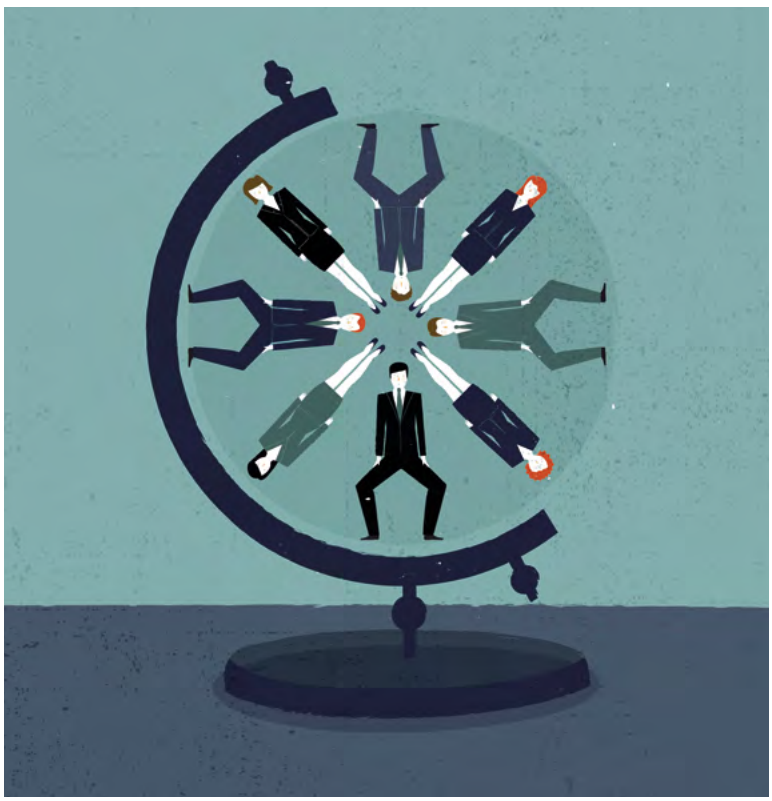
WHY DO THE FATF RECOMMENDATIONS MATTER TO CORPORATE TREASURERS ACROSS THE PLANET? NEIL JEANS EXPLAINS

The 2012 Financial Action Task Force (FATF) Recommendations set new guidelines for the information that legal entities, including corporations, should hold and maintain about themselves. These recommendations are already filtering into new regulations across the globe, with significant consequences for all corporate treasurers.

Globalisation and the greater focus on accessing and managing cash amid an ever-increasing volume of regulations have led to the responsibilities of the corporate treasurer increasing exponentially.

More and more boards are relying on corporate treasury teams to understand and interpret trading regulations, such as the European Market Infrastructure Regulation and the Dodd-Frank Act.

With the FATF Recommendations, this scope could extend to regulations governing anti-money laundering as well – making these yet another set of regulations that corporate treasurers need to juggle.



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Key points of the 2012 FATF Recommendations

One consequence of the 2012 FATF Recommendations for corporate treasurers is that organisations need to maintain and make available to a registry, operated by the authorities in a particular country, all the basic information set out below.

1. The organisation's name and proof of incorporation, as well as details of its legal form and status, the address of its registered office, its basic regulating powers (for example, memorandum and articles of association), and a list of its directors; and
2. A register of shareholders or members, which contains the names of the shareholders and members, the number of shares held by each shareholder, and details of the categories of shares (including the nature of the associated voting rights).

Developments across the world

Corporate treasurers need to know what impact the FATF Recommendations will have in different regions, since they might need to interpret what they mean for their organisation at an HQ and/or regional level.

Europe

The Fourth Money Laundering Directive (4MLD), which largely mirrors the 2012 FATF Recommendations, has passed its final legislative hurdle and will become law across EU member states in two years, following a vote in the European Parliament.

This directive has consequences for all organisations within the EU. The regulated sector (ie financial institutions) will be required to place greater emphasis on effectively identifying and mitigating risk, and there are key requirements around holding legal entity identity data, including beneficial ownership for companies.

Article 29 of the 4MLD incorporates the guidance in the FATF Recommendations as follows:

- Member states shall ensure that corporate or legal entities established within their territory obtain and hold adequate, accurate and current information on their beneficial ownership.
- Member states shall ensure that the necessary information about a legal entity can be accessed in a timely manner by competent authorities and by 'obliged entities' (entities covered by the anti-money-laundering legislation and regulation, for example, banks and financial institutions).

These requirements are aimed at legal entities domiciled within EU member states.

Australia

Australia has been one of the first countries to move its national law into alignment with the FATF Recommendations. The Australian Transaction Reports and Analysis Centre amended its anti-money laundering/combating the financing of terrorism rules in June 2014 to include, *inter alia*, the

collection, monitoring and maintenance of:

- Information about beneficial owners; and
- Details of the management and organisational structure of an entity (including names and positions held).

These requirements extend to all legal entities and effectively mean that they must maintain their beneficial ownership information and make it available when required.

US

In the US, the Financial Crimes Enforcement Network's (FinCEN's) proposed rules document indicates a move towards more stringent customer due diligence requirements, including more information about beneficial ownership.

Although the document does not imply that legislation is imminent, it could be argued that FinCEN is moving in the direction of requiring legal entities to hold and maintain beneficial ownership information.

Rest of the world

Other countries are also moving to amend their legislation in ways already seen in Europe, Australia and the US. It is clear that information about beneficial ownership is high on the agenda in many countries around the globe as a result of the FATF changes, as well as tax transparency and corruption initiatives at an intergovernmental level.

What is the impact for corporate treasurers?

The proposals and developments outlined above will have significant consequences for corporates, since they will be obligated, by law, to collect, verify, maintain, store and deliver relevant, up-to-date information about themselves on an ongoing basis.

The onus is on corporates to provide up-to-date information and to alert their financial institution to any relevant changes as they occur. These requirements have significant consequences for corporate treasurers, since it is likely that a large part of the responsibility to comply with them will fall on their already-burdened shoulders.

Moreover, each country will transpose the recommendations into its own national law, which could lead to banks and financial institutions interpreting them differently, with many erring on the side of caution and requesting more information than is strictly necessary.

With no consistent legislative 'standard', organisations will need to provide different sets of information for each financial institution that they do business with, leading to frustration and a significant duplication of effort.

There is also the concern over how corporate legal entity information will be stored and made available to the correct individual and/or organisation. The current methods of delivering highly confidential information via email or post are vulnerable to interception. Furthermore, organisations have no control over who can access their confidential information once it has been delivered.

Conclusion

As the complexity and number of regulations continues to grow, all stakeholders, including financial institutions and corporates, will need to understand the impact of additional regulations. For the FATF Recommendations, the onus will be on corporates to gather and maintain all necessary information about their organisations and, furthermore, to keep their financial institutions updated. This task will be both time-consuming and repetitive, delaying the pace of business and taking the focus away from other priorities.

This is a truly global issue. Those regions where there is currently no legal requirement for this enhanced information gathering and reporting can expect to be regulated in due course.

Corporate treasurers must weigh up the advantages of being early adopters of these expected regulations against the risk of the proposed legislation changing. Early adoption does offer many benefits: last-minute compliance projects can be difficult to implement if the requirements turn out to be more complex than expected and, furthermore, early adopters are often afforded the opportunity to influence the design of new compliance solutions.

Late adopters run the risk of professional advisers being fully booked in the run-up to a compliance deadline.

The consequences of non-compliance are well documented and include hefty fines and, often, severe reputational damage. In order to stay ahead of the regulatory curve, it would be prudent for corporate treasurers to view these expected changes as a catalyst to amend current processes and put procedures in place now to collate, verify and maintain their confidential information.

As the FATF Recommendations continue to filter into new regulations that will govern the daily duties of compliance officials across the globe, it is time for forward thinking and efficiency to take centre stage.

> For the FATF Recommendations, the onus will be on corporates to gather and maintain all necessary information about their organisations

ABOUT THE FATF

The Financial Action Task Force (FATF) is an intergovernmental organisation that was established in July 1989 as a G7 initiative to develop policies to combat money laundering.

The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

These standards are set through the task force's recommendations. The FATF also monitors the progress of its members in implementing necessary measures in response to the recommendations. There are 34 member jurisdictions and two regional organisations within the FATF.

Neil Jeans is head of policy for Thomson Reuters Org ID KYC Managed Service and has more than 20 years' experience in financial crime risk management

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PROTECTING THE P&L

WHAT DOES EVERY UK TREASURER NEED TO KNOW ABOUT ACCOUNTING FOR DERIVATIVES? KERN ROBERTS AND ZWI SACHO EXPLAIN

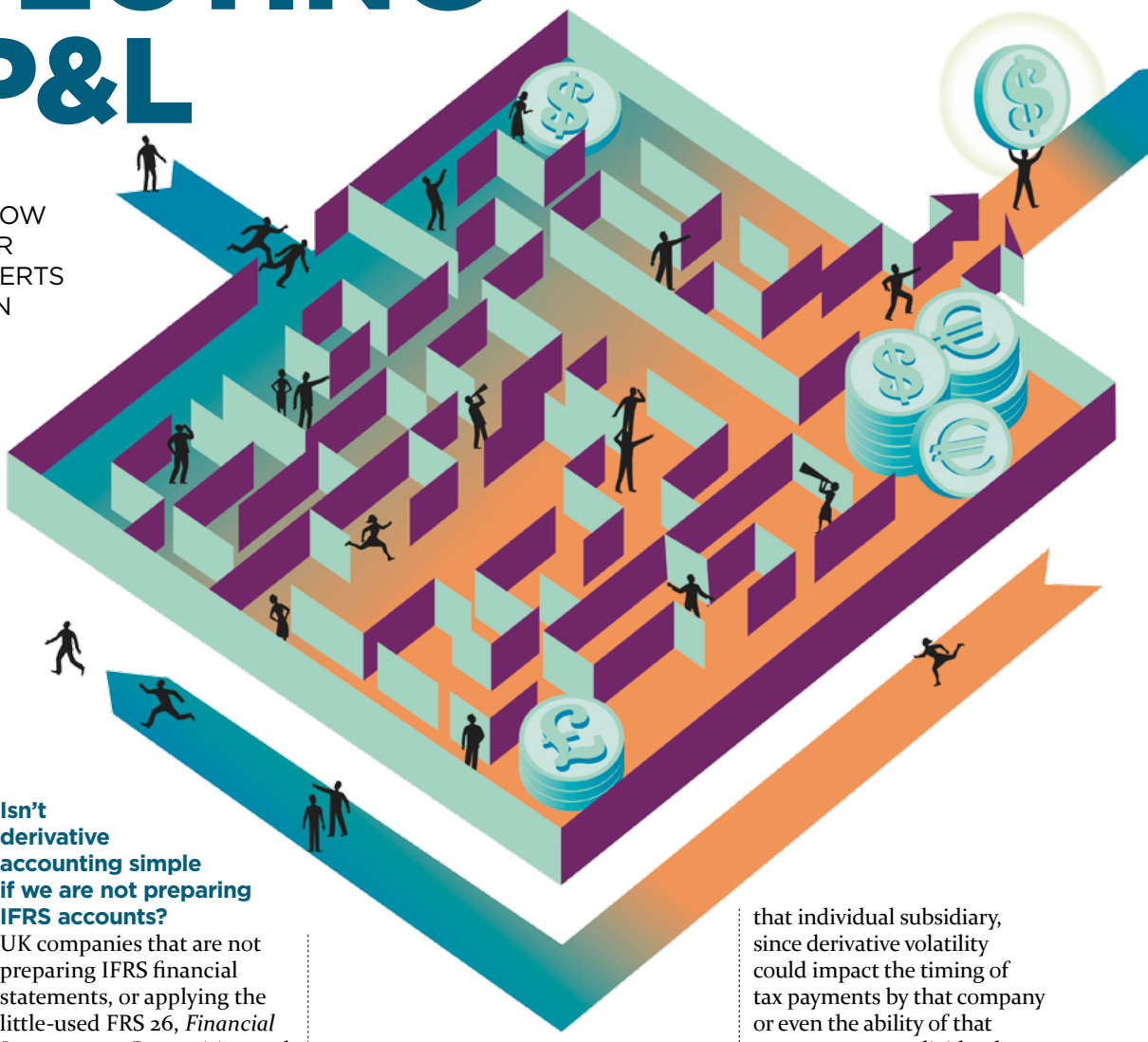


IMAGE SOURCE

We live in an uncertain world. Indeed, lately it has felt like the only certainty in the currency and commodity markets is volatility, and, with the US economy in particular showing signs of recovery, we may also soon be facing renewed interest rate volatility as well.

Consequently, risk management is near the top of every treasurer's to-do list. Managing risk, particularly where derivatives are used, requires treasurers to understand a broad range of impacts, and while economic and strategic considerations will rightly be foremost in the treasurer's mind, regulatory and accounting issues are of increasing importance.

In the past, derivative (and hedge) accounting has often been seen as the preserve of large or sophisticated companies and not as an area that every treasurer needs to understand. Following recent changes to UK accounting rules, however, all unrealised fair value gains and losses on derivatives will be recognised in profit and loss (P&L), unless hedge accounting is applied. So every UK treasurer who is involved in risk management will benefit from understanding the answers to the questions below.

Isn't derivative accounting simple if we are not preparing IFRS accounts?

UK companies that are not preparing IFRS financial statements, or applying the little-used FRS 26, *Financial Instruments: Recognition and Measurement* standard, have not in the past had to account for derivatives at fair value and, consequently, have not faced any of the challenges or considerations laid out below.

That is all changing for accounting periods starting on or after 1 January 2015, however, with the ushering in of an entirely new accounting framework in the UK (the so-called 'New UK GAAP').

For many UK companies, this will involve adopting FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland* unless EU-endorsed IFRS is being applied. Going forward, all UK companies will have to mark derivatives to market via P&L, unless hedge accounting is applied. And companies that have never considered accounting to be part of their risk management equation will have to think again. The changes will even affect subsidiary companies where there is not normally a focus on financial reporting, or at least not at the level of that individual subsidiary, since derivative volatility could impact the timing of tax payments by that company or even the ability of that company to pass dividends up the chain to other group companies.

Our counterparty provides a value each month for our derivatives. Can we use that for financial reporting?

With derivatives now being recognised in the financial statements of many companies for the first time, UK companies should expect heightened scrutiny from their auditors with respect to how the fair value of derivatives is determined.

UK companies may try to obtain fair values from their derivative counterparties, but such values do not normally provide information about the inputs and assumptions used in the valuation model, and therefore may not be readily auditable under the new UK GAAP framework. Therefore, hedging with derivatives can result in the need for third-party derivative valuations to provide independent, auditable numbers that are fully compliant with the relevant accounting framework.

Why is hedge accounting important?

Ultimately, any interest rate, foreign currency or commodity risk-management programme needs to be reported back to investors in financial statements.

The main purpose of hedge accounting is to modify the normal accounting rules to align the financial statement numbers more closely with the intended risk-management result. In the absence of hedge accounting, the default accounting rules for derivatives will result in potentially significant P&L volatility from 'unrealised' gains or loss on derivative hedging instruments.

Therefore, for companies whose financial statements are subject to significant investor scrutiny, or for whom reported profits are important for other reasons, the ability to qualify for hedge accounting becomes an important part of the risk-management discussion.

We frequently speak to corporates that consider the application of hedge accounting to be de facto mandatory, given the potential sensitivity of key numbers, such as earnings per share and EBITDA to derivative volatility. And, in these volatile times, there are plenty of real-world examples of companies for whom applying hedge accounting or not has been the difference between a profit and a loss.

What are the challenges and costs of applying hedge accounting?

The qualifying conditions for hedge accounting can be complex and vary, depending on the specific accounting standard being applied. And, in some cases, perfectly sound economic hedge strategies may either fail to qualify for hedge accounting completely or result in hedge ineffectiveness being recognised in profit and loss, particularly where an unsophisticated or reactive approach to hedge accounting is being taken.

Therefore, it is vital that a proactive hedge accounting approach is adopted with accounting questions being considered prior to trading the derivatives, since tweaks to the structure that might have facilitated hedge accounting will rarely be possible once instruments have traded, at least not without introducing additional cost and accounting inefficiencies.

A proactive, well-considered approach will also allow for the application of more sophisticated hedge accounting techniques, such as regression testing, proxy hedging or carefully defined exposure 'buckets'. Such techniques, where appropriate, can be used to minimise the ineffectiveness arising from hedge relationships or even, in some cases, allow hedges to qualify for hedge accounting when they would have failed to meet the qualifying criteria had a more simplistic approach been adopted.

The additional administrative burden and complexity mean that many companies find it is not cost-efficient to run a hedge-accounting programme in-house, and outsourcing the work to a specialist hedge accounting provider or hiring additional specialist staff may be the preferred option.

Many companies find that failing to apply hedge accounting has real cash impacts for their business

Why would a private company choose to jump through the extra hoops required to apply hedge accounting?

Private companies may feel that hedge accounting is not for them. Having a smaller investor base, private companies have more scope to explain any P&L volatility to their stakeholders, and the administrative burden of running a hedge accounting programme may seem unattractive.

P&L volatility arising from derivative accounting is not purely a financial reporting issue, though. Where hedge accounting is not applied, derivative volatility may restrict the ability of a company to pay dividends and thereby return cash to investors, result in volatile tax payments that are not aligned to underlying profits, and, in some cases, result in companies breaching their loan covenants.

Consequently, many companies, both private and public, find that failing to apply hedge accounting has real cash impacts for their business. A recent example of this outcome occurred when a company with long-dated interest rate swaps was unable to pay dividends to its investors, despite the presence of underlying cash profits, purely because of unrealised losses associated with those swaps. Conversely, if the company had chosen to apply hedge accounting from the inception of the hedge, dividends consistent with the historic dividend yield could have been paid.

Conclusion

Today's treasurer does not necessarily have to be fluent in hedge accounting or fully appreciate all the deep technicalities, but a broad understanding of when it would be beneficial to apply hedge accounting and how hedge accounting considerations can impact the holistic risk-management discussion are increasingly required. The recent changes to UK accounting standards mean that accounting for derivatives is no longer only an issue for larger or more sophisticated companies. Now every UK treasurer who uses derivatives to manage risk needs to be aware of the accounting ramifications.


Kern Roberts (left) and **Zwi Sacho** (right) are directors of hedge accounting, at Chatham Financial

Chatham Financial

KEEP YOUR OPTIONS OPEN

YOUR BANK MAY BE TRYING TO SELL YOU HEDGING PRODUCTS, BUT THAT DOESN'T MEAN YOU SHOULD OVERLOOK THEM, ARGUES JAMES DUCKER

LIGHTSPRING/SHUTTERSTOCK

For many years, I have been aware of some worrying trends in FX hedging, trends that need to change. During my time working in UK banks, I saw that they assessed their clients' hedging policies, which resulted in the finding that spot contracts accounted for around 80% of all contracts, forward contracts around 15% and options around 5%.

Since options generate more profit for a bank, the aim of the assessment was clearly to encourage more clients to switch to options. During the meetings where we fed the results of the assessments back to the clients, we usually discussed how options were in fact 'better' for clients. There ensued a sometimes quite interesting debate around spot, forwards and options.

Unsurprisingly, the end result of the assessments was to encourage options, since they made more profit for the bank, and added to salespeople's bonuses. But that misses the important point that options are indeed an excellent hedging tool that are often overlooked, ignored or specifically omitted from a hedging policy.

A constant and interesting debate is what is riskier – spot or forward contracts? The answer, as always, depends on your business. In other words, it depends neither on the market, nor future expectations, nor the bank's technical analysis. Instead, it depends on your business; its needs; its goals; its targets; its sales; its potential sales; its potential timing of payments and receipts; its flexibility with regard to altering fees to suppliers; its flexibility with regard to altering consumer fees; and, lastly and generally overlooked, its competitiveness (at quoting, ongoing service and end result stage).

Let's take a look at the example in the table below, assuming the company is selling sterling and buying US dollars.

This first stage of assessment shows absolutes only – the rate moves higher or lower, and it appears to be a binary outcome. Looking at it in this way, it is evident that both spot and forward contracts are risky. It is a risk if you look at spot, but, equally, it is a risk if you look at forward contracts. That is not to say that an element of risk should be dismissed, but, clearly, corporates using 80% spot and 15% forwards are massively overweighted in these contracts.

	£/$ MOVES HIGHER	£/$ MOVES LOWER
SPOT	Good outcome	Poor outcome
FORWARD	Poor outcome	Good outcome

This table doesn't even take into account the flexibility that exists around reneged contracts, unforeseen contracts and potential contracts – all of which are impossible to cater for with spot and forward contracts, unless even more risks are taken.

So it seems natural to ask what else can be done? If spot and forwards are too risky in themselves, if more flexibility is needed, and if less binary risk is desired, then which solutions exist?

We come back to what banks want to sell – options. This, in turn, poses the question as to why, if banks are trying to sell them, and corporates should be using them, they are not used more extensively? Ultimately, that is a question for corporates to answer. But my view, and what I hear consistently, is that businesses feel that if the bank is trying to sell a product, but that bank is unwilling to advise and is manipulating FX markets along with other markets, then it is best to avoid that product. In this case, it is simply not true, however. Yet businesses are showing a worrying trend of not using hedging, but instead choosing to accept risk that is unquantified and often unknown.

Anything is possible with options

It may sound like a sales pitch or a flippant statement, but anything is possible with options. There are some aspects of options that may have to be altered, primarily premia, notional value, length of contract and risk appetite. There are other aspects, of

course, but altering these four aspects can fundamentally affect any type of options contract that you want or need for your business.

If we look at the £/€ currency pair at present, the expectations are varied. Of the approximately 80 institutions who post expectations on Bloomberg, the highest expectation for Q1 2016 is 1.5380; the lowest is 1.3150. This is a variance of around 22 cents or 17%. Let's assume for a second that the institutions may know more than we do and there is a possibility of a 17% swing, or an approximate 6% swing lower from the present exchange rate versus 9% higher. If a business uses spot, then they are taking (according to the market) a risk of losing 6% off their profit margins. If a business uses a forward contract, then they are taking a risk of 'losing' profits of 9%. This is, of course, against a backdrop of unknown budget rates and sales rates.

Businesses, in general, do not understand and do not appreciate the FX 'risk' they are taking – both the risk of losses, but also the risk of opportunity cost, and arguably, most importantly, the risk of competitive disadvantage. If a business uses a forward contract, then it is locking in its rate and is implicitly expecting the rate that it is dealing in to worsen.

	£/$ MOVES HIGHER	£/$ MOVES LOWER
SPOT	Good outcome	Poor outcome
FORWARD	Poor outcome	Good outcome
VANILLA OPTION	Good outcome (minus premium)	Good outcome (minus premium)

HEDGING POLICIES

It is important for many reasons to have a hedging policy that is preferably written and signed off by the board or MD. A hedging policy gives scope and overall approval from the business to whoever controls the FX decisions. It also ensures that the business can operate in a known policy area without straying and causing potential losses or risks that it is not prepared to take. But where do hedging policies fit into this discussion about options? Quite simply, spot and forwards do not offer enough flexibility in all senses of the word. That is why large corporates tend to have treasury policies that encompass options.

I have come across many comments from corporates along the lines that they don't care about opportunity cost – they see that as speculation. I haven't come across many comments around competitive disadvantage, however. If we use the £/€ currency pair as an example, a business may buy euros and sell sterling, locking in at current rates. In a year's time, it will buy its stock at a cost that is 9% more expensive than the cost paid by a competitor. This presents the business with an interesting decision – it can either take the cost of the stock off its profit margin, assuming that it has a profit margin higher than 9%, otherwise a loss is made or it can pass the cost on to consumers – effectively making its products 9% more expensive than those of their competitors. This consideration is too important to be overlooked and ignored in the decision-making process.

The role of options

So how do options help businesses to manage their FX risk?

The basic option is a vanilla contract – this is a right, but not an obligation, to buy a certain amount of currency at a set strike rate on a certain date. A premium is paid. If the market has fallen below the strike rate on maturity of the contract, then the client has the right to buy the currency at the strike rate (ie above the prevailing spot rate).

If the market is above the strike rate, then the business can ignore the protection that it has purchased and buy at the prevailing spot rate. This contract means that the client has 100% protection, but the ability to benefit on 100% of the notional value of the contract if rates move in its favour. See the result when we add this to the table (below, left) – assuming a GB sterling seller and US dollar buyer.

Worrying trends

No one knows where FX rates are moving. Therefore, corporates should not take positions without full knowledge of the risks involved. Positions need to be taken with due consideration of the business, competitiveness, the market and unexpected events that require flexibility. If we look at £/€ over the past 10 years, we can see how unpredictable and varied rates can be. Trends in FX should move towards businesses having FX policies agreed, checks on rates, pricing and strategies, and taking a portfolio approach – including spot, forwards and options.

James Ducker is director at Benchmark Treasury Pricing

FUNDING STRATEGIES

WHAT ARE THE LATEST TRENDS IN THE WORLD OF RESTRUCTURING? JESSICA WALKER GIVES THE LOW-DOWN

ILLUSTRATION: ALAMY

Since the 2008 global financial crisis, the restructuring market has been volatile and changeable. Over the past few years, new players and processes have entered the market, creating a vibrant environment for companies looking to find ways to continue to trade and grow.

In this article, we will look at some examples of tools that have been used by companies to raise funds and restructure debt. We'll also consider what events are likely to impact these tools and influence the ways in which restructuring is affected in the future.

What is happening now?

Recently, borrowers across Europe have benefited from low interest rates and easy access to capital. As a result, we have seen many businesses refinancing, including through a number of high-profile bond issues. For example, UK retailer New Look Group announced earlier this year that it was issuing £1.2bn of bonds to pay down debt following the acquisition of the New Look Group by investment company Brait.

Bond issuance is not the only method that has been used widely to restructure corporate debt, however. The English scheme of arrangement (a court-approved agreement between a company and its shareholders or creditors) has become a widely recognised tool to restructure debt, even where it is not immediately apparent that the entity or debt in question is sufficiently connected to England to enable the English court to accept jurisdiction. In the past couple of years, we have seen many examples of the

English court sanctioning schemes of arrangement of foreign companies that do not have assets in the UK, including for Vietnamese, German, Dutch, Irish and Italian companies.

There is no doubt that more traditional methods of fundraising remain popular. Many banks have been content to amend and extend existing facilities to enable businesses to continue to trade through a short, difficult time, anticipating that more robust refinancing packages can be put in place once there is greater certainty in the relevant borrower's market.

Borrowers have also had the benefit of a swathe of alternative credit providers entering the market, who are often able to respond more quickly and are willing to take greater risks than traditional lenders, consequently providing a much-needed resource for many borrowers.

What will be the right restructuring tool for a business will often depend on where the impetus for the restructuring comes from. If the borrower is looking to increase its lending or obtain a more favourable lending rate, or if a lender is looking to exit a relationship with a borrower where there is no event of default (for example, because the lender wishes to exit a particular sector), it is not difficult to see that both borrower and lender will be inclined to be more creative, and perhaps be more likely to look to a scheme of arrangement or a bond issue as a way to create value.

But the borrower may be left with fewer options where the catalyst for the restructuring is a potential breach of covenant or event of default. In those circumstances, to avoid insolvency, a borrower may have no choice but to amend and restate existing facilities on less-favourable terms, while operational changes are implemented with a view to facilitating a more profitable business, which, in turn, leads to more options for future refinancing.

What will the future bring?

Given the continuing uncertainties in economies throughout the world, it is entirely possible that the current conditions in the restructuring market will have to change. In particular, there are several key influences that are likely to impact the choices available to a borrower looking to restructure its debt.

Interest rate increases

Interest rates around the world are at a record low and it's clear that they cannot stay at their current levels forever. The precise timing and strength of a rise in interest rates is beyond the scope of this article, but there is little doubt that a rise is coming (at the time of writing, the Bank of England governor had suggested that an interest rate rise was "drawing closer" and rates are expected to rise in early 2016) and it would most probably affect the availability of funding to borrowers, especially those in stress or distress.

Grexit?

Resolution of the Greek financial situation is still far from certain, despite the fact that an agreement seems to have been reached to provide Greece with up to €86bn over three years conditional on the country implementing economic reform in a number of areas. If this agreement were to fail and Greece were to leave the euro, the repercussions might affect the availability and cost of funding across the whole of the continent.

ECB's AQR and forbearance rules

Following the asset quality review (AQR) carried out by the European Central Bank (ECB) in 2014, many banks throughout Europe are facing a number of new considerations. Not least of these are the implications of new forbearance rules, which require banks to report to the ECB on all potentially distressed borrowers. The result of these rules may be to limit the potential for extension and restatement of existing debt where this would impact on the relevant bank's obligations to the ECB. This may, in turn, require borrowers to consider alternative and more creative sources of funding.

Alternate lender regulation

The growth of the alternative lender market over recent years has led to calls for regulation in this area. Currently, alternative lenders do not have the same restrictions, reporting obligations and capital requirements as banks, and are therefore often able to take risks when lending, which traditional lenders are unable to take. If their share of the market continues to increase, the regulatory bodies may well decide that alternative lenders should be regulated in a similar way to banks, which is likely to impact on the availability of funding to many borrowers. That said, there does not appear to be any current proposal to introduce regulation at the time of writing.

What is the role for treasurers?

A company's treasurer will be central to any decisions with respect to the firm's debt position. The key to a successful restructuring is communication between borrower and bank or new funder. The treasurer will provide the bank or funder with an established point of contact with whom the lender can share necessary information and will subsequently be integrally involved in the implementation of the restructuring. Internally, the treasurer can be a source of information about the various options available to the firm when refinancing is required. By keeping abreast of market trends, a treasurer will be well placed to direct the firm towards the best possible outcome.

Outlook

Where is the market going? Given the volatility of the markets and the plethora of influences on economies, it is not possible to say with any certainty. The only thing that is certain is that the restructuring market will continue to evolve and provide options for borrowers, and that treasurers are in a prime position to influence this.

Borrowers across Europe have benefited from low interest rates and easy access to capital. As a result, we have seen many businesses refinancing

Jessica Walker is senior associate at Mayer Brown International LLP

TONE FROM THE TOP

HOW CAN YOU BECOME RECOGNISED AS A VALUES-LED LEADER? JO SIMPSON EXPLAINS

Values-led leadership starts with you – the leader. It is about becoming more consciously aware of what is most important to you, and what is driving you, your decisions, your relationships (personal and professional) and the goals/objectives you set and achieve (or not, as the case may be).

Most leaders don't truly know what is really driving them, however. We hear the term 'values-based or values-led leadership', but what does it really mean?

Values explained

Let's start with what it's not. A large majority of companies take an outside-in approach and impose the company values on to each individual who works for the company, ie these are our values and behaviours, and they need to be honoured.

This approach doesn't work for many reasons, but mainly because the individual isn't engaged or aligned. Now, of course, it is important for people to honour the company values, but this honour needs to come from the inside out, with each person taking the time to really discover their own core values and only then to align with the company values, looking at them through a lens of their own.

As an example, let's say your organisation has a company value of 'great customer service' and you have a personal core value of 'making a difference'. The leader with 'making a difference' as a value could easily see how they could align to the company value through the lens of 'making a difference'.

So, how do we discover our values? This is best done through someone, ideally a professional coach, asking you some powerful questions. I like to keep the process simple and use a three-step approach: Discover, Define, Ignite™.

Take the time to really Discover your core values (see box, Three Powerful Questions for Values Discovery, opposite) and then Define what each one means to you. This is a very important step, and the absence of this is at the heart of a lot of communication breakdown and conflict.

One word means different things to different people.

> Your values are what matter most to you in life, so bringing them into your communication is vital

ILLUSTRATION: GETTY

How often do you take the time to ask yourself, "what do 'freedom' or 'honesty' mean to me?"

Once you are clear on your core values and what they mean to you, it's time to Ignite them in all that you do – in your decisions, communications, visioning, goal and objective setting, hiring and firing, and resolution of conflict.

Our core values are at the heart of everything we do, whether we are consciously aware of them or not, and it takes courage to fully live them and to be a values-led leader. Being true to ourselves is often more difficult than 'fitting in' or 'doing what we think we should do' in the short term, but if you carry on 'being someone you are not' for too long, you will become restless and frustrated, and eventually feel drained.

Let's explore a few areas, where you can step into that place of courage and lead from your values.

Conscious choice

Do we always have a choice? The answer is 'yes', although sometimes it may not feel like it, or perhaps there are things that we 'have to do' that don't necessarily bring us joy.

Once you can own the fact that you always have a choice, it brings empowerment and a sense of liberation. So, what about the things we 'have to do' – for example, that long report that will have an impact on other people or the business, if it is not done? Find a way for it to meet some of your values. If you have values of 'connection' and 'fun', don't sit there doing it alone – get some support and make it lighter, and see how much easier it is to accomplish when you consciously ignite your values into the task.

Courageous communication

Your values are the things that you hold most dear. They are what matter most to you in life, so bringing them into your communication is vital, and they are especially helpful when you are dealing with difficult conversations.

Let's say that you are 'in conflict' with another person. Instead of having a disagreement, or trying to get your point across, try asking through curious questioning, what is important to the other person about the situation, and then share what's important to you. Not only will you have an easier conversation, you will gain a depth of understanding about what is driving each one of you and it's likely that, going forward, you will work in a more collaborative and respectful way.

Projection of values

The more we become aware of our own set of values, what they mean to us and the priority we place on them, the more we appreciate that others have their own set of core values with different meanings and a different priority order. This is what makes us unique and interesting.

Without this awareness, we can unconsciously project our values on to others. If person A is driven by respect, excellence and focus, and person B by positivity, adventure and fun, imagine how this plays out when they work together.

Unless each person is aware of their own values and those of the other person, a lot of frustration can ensue, since each person believes their way is the right way. Person A may just want to get the job done fast and achieve the highest possible results, whereas to person B, the way it's done would be more important – it would matter more to them that is done in a positive way and ideally with some fun. Be aware of what you are projecting on to others and notice what others may be projecting on to you.

Being triggered

The next time you get 'triggered' or someone annoys you, take the time to reflect and ask yourself which of your core values has just been impacted.

If someone is late for a meeting, it could have triggered your 'respect' value, or if someone is negative around you, it may impact on 'positivity'. The more we become aware of which of our values are triggered, the easier it becomes to find a sense of peace within.

When we know why we feel the way we do, it lessens our feelings of frustration or anger. By all means, have a courageous conversation with the other person, but do it from a calm place. We know that we have no control over what others do – yet unconsciously, it is this that triggers us the most.

Focus on honouring your own values first and foremost, and let go of expectations from others. You will see the difference that it makes to your wellbeing and peace of mind.

Being a values-led leader means being true to yourself, no matter what. Values can't be imposed or picked from a list; they must be discovered from within. Enjoy the discovery.

FIVE WAYS TO BECOME A VALUES-LED LEADER

1. Be true to yourself and honour your values in all that you do.
2. Express your truth.
3. Make courageous decisions and set goals that are aligned with your values.
4. Trust your intuition.
5. Lead from the inside out.

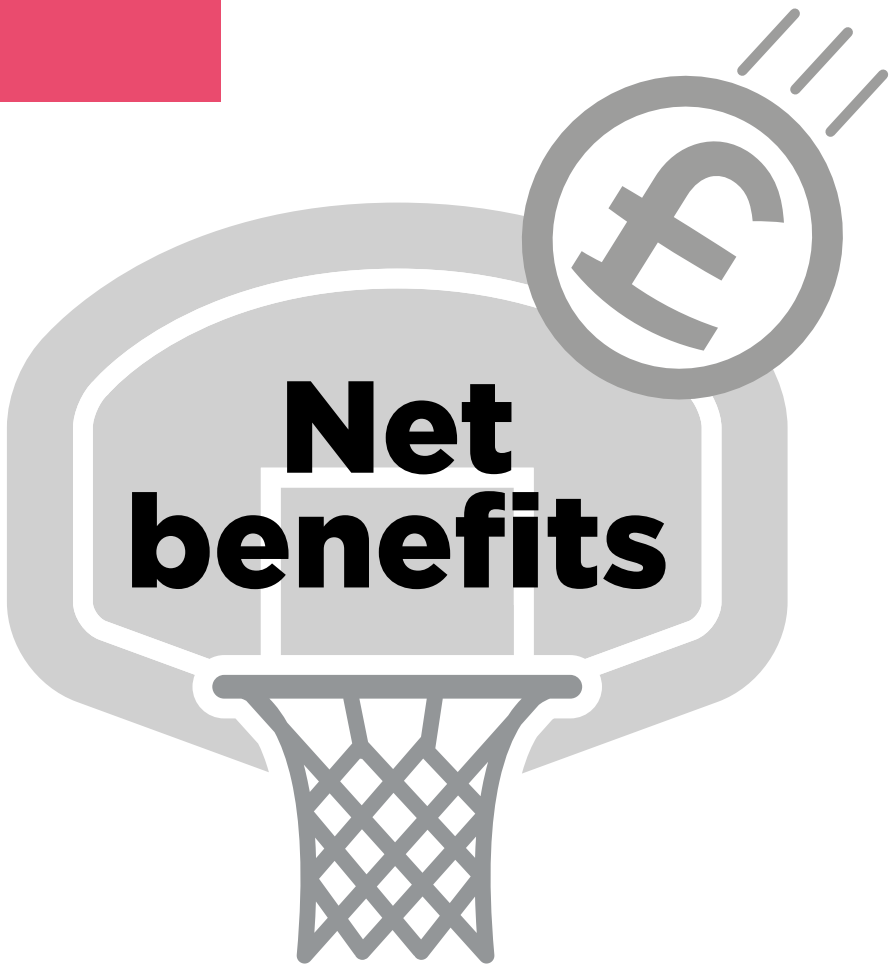
THREE POWERFUL QUESTIONS FOR VALUES DISCOVERY

Q1. What's important to you?
What does that give you? (Delivering on promises may be important and it could give 'integrity' or 'honesty', which are the core values in this case.)

Q2. What do you enjoy?
What does that give you? (Working on projects with others could be enjoyable and give 'connection' or 'teamwork' – the core values.)

Q3. What frustrates you?
Flip the answer over to the opposite that resonates with you, to elicit your core value (ie if you get frustrated by deceit, your value might be 'honesty' or 'truth').

Jo Simpson is an executive leadership coach and keynote speaker, who specialises in values-based leadership. She is author of *The Restless Executive*



Net benefits

Netting is a simple and powerful tool, with important practical and assessment challenges. Doug Williamson investigates

Netting offsets receivables against payments due, to reduce net payments and save transaction costs. This frequently assessed topic is one of the key tools used by companies that have a centralised treasury function. The benefits of netting can be quick and substantial, especially if there is a lot of intercompany trading.

Immediate savings

Netting reduces the number, average size and cost of payments. This is because:

(1) Only those with a net obligation make a payment.
(2) Those making payments only pay net, after deducting receivables.
(3) Fewer and smaller payments will usually be much cheaper.

As a result of the reduction in payment flows, there are also substantial benefits from reduced:

- FX commissions; and
- Losses arising from money being in transit ('float').

Bilateral netting

Let's assume we are a British, sterling-based company. Let's say we are due to pay €800,000 and, at the same time, we are owed €785,000. In the absence of netting, the total amount of all the gross payments and receipts would be:

€800,000 + €785,000
= €1,585,000

With bilateral netting, our payment is reduced from €800,000 to our net obligation of:

€800,000 – €785,000
= €15,000

Transaction comparison (€000)	Without netting	With netting
Payable	800	15
Receivable	785	-
Transaction total	1,585	15
Number of transactions	2	1

In this simple example, our number of transactions is halved, from two to one. The money volume of transactions is reduced more than a hundredfold, from €1,585,000 to €15,000, with immediate cost savings.

Save more

Most groups of companies use 'multilateral netting' to save even more. Multilateral netting is where three or more parties agree to net their obligations.

Multilateral netting can be within a group of companies or a collective of third-party participants. In the rest of this article, we'll focus on groups of companies.

SAVE EFFORT

The United Arab Emirates' Easa Saleh Al Gurg Group created a centralised treasury department, complete with in-house bank, to consolidate cash management responsibilities that had previously been dispersed among the 23 different companies within the group.

Using a treasury management system, it now carries netting across all its bank accounts on a daily basis. Previously, getting consolidated daily cash balances across the group used to entail major time and effort.

This smooth, automated process has effectively eradicated debit balances. As a result, the group saved around AED 3m (£500,000) in interest payments over a year, a very substantial sum for the group. *Easa Saleh Al Gurg Group was named Small/Medium Treasury Team of the Year in the ACT Middle East Deals of the Year Awards in 2013.*

Centralise

Multilateral netting needs a netting centre that acts as a counterparty to all the subsidiaries in the group. The netting centre is usually operated by the central or regional treasury centre. Using a netting centre, transactions are all recorded and then netted off. There is only a single net payment or receipt for each subsidiary.

Supplier payments

Third-party currency payables may also be included. Either the netting centre or the local subsidiary pays the third party locally, as paying agent for the group. The amount disbursed is then settled through the netting system.

This process is sometimes called POBO (payments on behalf of).

Customer receipts

External receipts are more tricky than payments. A recent assessment explored the practical problems.

> Discuss the issues that may arise when a third party pays the money they owe one subsidiary into a group's multilateral netting system.
>
> *International Cash Management (CertICM), October 2014, Q4(d)*

Where does the money go?

When a third party ('Customer C') pays the money it owes one subsidiary ('SupplierSub') into a group's multilateral netting system, the payment goes into a bank account owned by either:

(1) The group's in-house bank, if there is one; or
(2) A local subsidiary company that acts as a receiving agent for the domestic currency receipts of other group companies.

These accounts are then included in the multilateral netting system in the next netting cycle. These arrangements are sometimes known as COBO (collections on behalf of).

What's the problem?

Two major issues that arise with external customer receipts are:

(1) Indemnity; and
(2) Intercompany loans.

(1) Indemnity

A fundamental duty of a bank is to pay the person the bank's customer tells it to pay, and not someone else.

Continuing our example, Customer C needs to pay SupplierSub, the group company that supplied it with goods or services. SupplierSub is also known as the 'beneficiary'.

Problems can occur over the acceptability of Customer C's bank making a payment to an account that is not owned by the beneficiary SupplierSub.

In the UK, for example, banks may have a liability to Customer C for any funds 'incorrectly diverted' to a different bank account than that of the intended beneficiary.

In the UK, the banks would require an indemnity for 'incorrectly diverting funds to another account'. The group's indemnity obliges the group to reimburse the bank for any claims or losses that might occur. This was a knowledge gap for many recent candidates.

> **Incomplete answers**
>
> "Very few candidates gave full answers including issues of bank indemnities."
>
> *Examiner's Report, CertICM, October 2014*

(2) Intercompany loans

A second issue can arise if too long a time passes between initial receipt of the funds and on-payment to the beneficiary SupplierSub, via the netting system.

Delayed payments to SupplierSub could be deemed to be interest-free intercompany loans from SupplierSub to other group companies.

This can create problems of interest allocation and withholding tax between the group companies. Therefore, groups that use these techniques tend to run their netting more frequently, despite the added cost of doing so.

Leave it out

Another potential issue with third-party receipts is reconciliation.

For these good reasons, external receivables are usually excluded from multilateral netting systems in practice.

Clean sweep

Turning to your studies, gather the learning material and practical insights into your net at an early stage, where they can be integrated. You can then identify any potential problems or knowledge gaps, and tackle them. Full and timely work will greatly improve efficiency and pay-offs.

Sweep as many learning opportunities as you can into the net, and enjoy the predictable benefits.

With many thanks to Michèle Allman-Ward for her much valued advice and guidance.

HELP FOR ACT STUDENTS

Download this and other 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

Doug Williamson is a treasury tutor and finance coach. He enjoys seeing you net financial and time-saving benefits for your organisation and for yourself

RATCH/SHUTTERSTOCK

SPOT THE DIFFERENCE

WHAT DISTINGUISHES ONE TREASURY FROM ANOTHER? WILL SPINNEY EXPLAINS

No two treasuries are ever the same. The major influences on a treasury probably relate to who owns the company, the sector the company operates in, its size and geography, its financing arrangements and credit quality, and the responsibilities that it gives to its treasury. In addition to this, cultural differences, such as attitude to risk and individual styles, are also an influence.

Ownership

The ownership of a company dictates where the power base sits and where the financial strategy may originate. In a private equity- (PE) or family-owned business, this will be with the owners, and they will dictate the plans for initial public offerings, dividends and so on. As a result, treasury may not be involved with any financing – in contrast with a quoted company, where regular fundraising would be a feature of treasury's role.

Sector

The sector that a company operates in will influence its treasury's main activities. For example, an airline treasury might focus heavily on risk management, where commodity (fuel) risk and FX risk are key drivers of profitability. A retailer might concentrate on cash collection and the payment of many suppliers.

Size and geography

The staffing and roles of a treasury will generally go up with company size and geographical footprint. The larger the company, the greater the number of banks that may be required, leading to increased complexity, yet international footprint is arguably the main driver of treasury size.

Every country where the company has overseas subsidiaries and operations will have different laws and regulations, requiring a highly individual approach. This is compounded when customers and suppliers are equally diverse. So a national retailer will have a small treasury, whereas a multinational on several continents will have many cash management and corporate finance professionals.

Financing and credit quality

High debt or leverage in itself is not so much a factor in treasury activity, but the frequency of financing can be. A PE-financed business will lock in its finance for several years, but a utility, property company or airline will be almost continuously in the market for new debt of one form or another, which will make up a large part of its treasury's activity. Such highly active companies might well have to spend a lot of time with rating agencies to ensure rating stability, or at least control over rating outcomes, as well as with other creditors, which may be concerned with high leverage, including credit insurers and pension schemes.

Treasury responsibilities

While the ACT defines the role of treasury fairly widely, treasurers, as employees, can really only do what is shown on their job description. Treasurers should make their views known on issues where they can add value, but, more likely, is that the treasurer will be involved in many things beyond treasury, such as pensions, working capital, insurance and property.

Implications

There are probably two major implications that come out of these different ways of managing a treasury with respect to staffing and change management.

First, let's look at staffing. The differences tend to lead towards specialists in both sector and role. What are the implications of this from the point of view of both manager and employee? For the manager recruiting a new team member, it will always be tempting to employ someone who has relevant experience, which limits the pool of candidates. But the treasury training should allow a treasurer to move freely within the profession, applying the basic principles that exist everywhere.

Career matters

For an aspirational treasurer, there are probably two concerns arising from this. Should a particular job function or company type be sought to add to the CV and should it restrict any job searches? While it is always good to get certain names or roles on your CV, neither of these guarantee future success. The principles of treasury apply everywhere and a variety of experience, especially some gained from being close to business operations, can easily trump a good name. Professional qualifications from the ACT for the treasurer and their team are increasingly a must-have on a global basis.

Change may be very difficult to implement. Any investment or disruption will be challenged and so the treasurer will have to choose which battles to fight and be prepared to prove a return on any investment. Quite often, however, opportunities arise unexpectedly, such as after a crisis, or following an acquisition, and treasurers should take advantage of these to implement change.

Will Spinney is associate director of education at the ACT

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THE HEART OF TREASURY

Mr Treasurer explains to the board how treasury earns its seat at the table

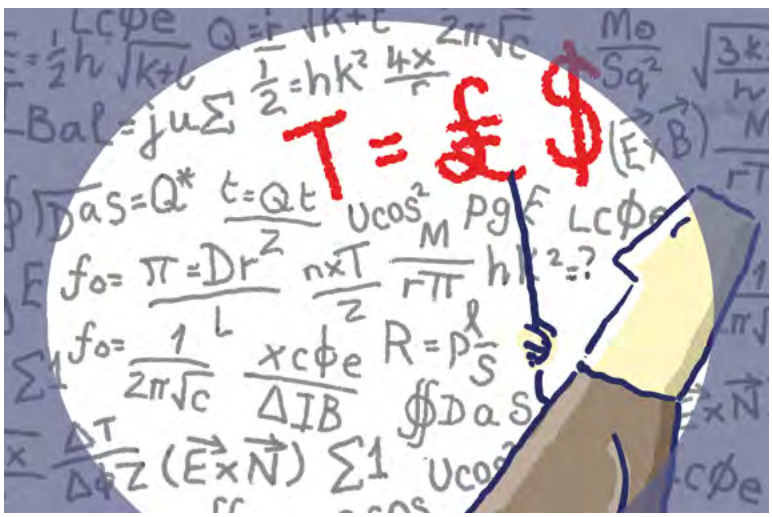

ILLUSTRATION: IAN DICKS

"I've been thinking," said the CFO – and never did three simple words make Mr Treasurer's heart sink so.

"I think at our next board meeting you ought to do a presentation on what treasury is about," the CFO explained. "Tell them what treasury's *raison d'être* is. Tell them..."

The CFO is going to say '*mission statement*', thought Mr Treasurer to himself.

"Tell them treasury's *mission statement*!" said the CFO. "Show how treasury earns its seat at the table. Now go knock something up and we'll run it up the flagpole."

So Mr Treasurer spent the rest of the afternoon knocking up treasury's mission statement. *Treasury's primary function is to not lose any of the company's cash*, he wrote after a few hours' hard thinking. He showed it to the CFO.

"What? Is that it?" the CFO cried. "No, no, no. This simply won't do! We can't make a 20-minute presentation out of that!"

So Mr Treasurer spent the next morning putting together a presentation that talked about risk management and debt profiling and funding strategy. He even drew a little diagram – a triangle divided horizontally into three parts, with the base labelled 'Security', the middle tier labelled 'Liquidity' and the top bit labelled 'Yield'. He showed it to the CFO.

"Now we're getting somewhere," the CFO said. "But I'm sure we can do *much* better than that."

So Mr Treasurer spent the rest of the day writing the presentation that he had, in his heart of hearts, known all along that he was going to have to prepare. It contained words and phrases such as 'business partnering', 'alignment with strategic objectives', 'reaching out', 'holistic', 'cross-silo collaboration', 'added value', 'process efficiency', 'optimisation' and even 'centre of excellence', 'stakeholders' and 'communication'. Every syllable of business jargon Mr Treasurer wrote made him wince in agony; every three-letter acronym tore at his soul. He showed his third draft to the CFO.

"Excellent!" the CFO exclaimed. "*This* we can take to the board."

And so, two weeks later, Mr Treasurer found himself with a PowerPoint slide deck, a laser pointer, a very dry throat and an attentive board. He hated every moment, although he was just a little bit pleased with his diagram that put the word 'Treasury' in a large circle, surrounded by lots of smaller circles connected to it containing all the buzzwords that Mr Treasurer could think of. Meaningless tosh, of course, but it looked great.

Twenty minutes later, Mr Treasurer stopped talking. "Um, any questions?" he asked the board members. There was a deafening silence.

"Hmm," said the chairman, who sounded entirely unconvinced by what he had just heard. "Well, obviously a lot of thought and work have gone into this," he said politely, and if Mr Treasurer's heart had sunk when the CFO first announced this great idea a fortnight ago, at this moment it dug a hole in the floor and buried itself.

"And I think I see where you're going with this," the chairman continued. "But wouldn't it just have been simpler to summarise all this management gobbledegook by saying that treasury's primary function is to not lose any of the company's cash?"

"What a good idea, Chairman," said Mr Treasurer. The CFO went quite pale. Mr Treasurer permitted himself just the tiniest of little smiles to himself. And his heart soared.

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

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The highlights of the September 2015 issue of *The Treasurer* include: The ACT's role in setting professional standards in treasury and banking. See page 18. Ian Chisholm, vice president capital markets at Shell, takes us behind the scenes in the oil business, on page 22. Our 15-page special on cash and liquidity management starts on page 27. Find out why the Financial Action Task Force Recommendations matter to corporate treasurers, on page 48. Discover how you can become a values-led leader, on page 56

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Who we are

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Kyra joined Michael Page Treasury in 2001 and was promoted to Director in 2009 when she started focusing on executive recruitment in corporate treasury. Since then she has worked with a number of clients ranging from FTSE100 to PE backed businesses across England. Kyra has an unrivalled network and deeply entrenched relationships within the treasury world.

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