



## What about yield?

Yield has diminished in importance since the financial crisis, effectively falling into third place behind security and liquidity as investment priorities. Will new regulations coming down the pipeline upset this balance?



### Women in Treasury

**Diane S. Reyes**

Global Head of Payments and Cash Management  
**HSBC**

### SWIFT for corporates

Voyage into the inner sanctum

### Writing a bank RFP

A checklist for selecting a partner



### The Bank Interview

**Bruce Proctor**

Global Trade Head  
**Bank of America Merrill Lynch**

### Sculpting a masterpiece

Building a treasury from scratch

### Accounting rules

Convergence is the word du jour



Wisdom will be recognised

**Adam Smith Awards 2013**

in association with

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# Final call to action

## Nominations close at midnight on 30<sup>th</sup> April

By the time this issue hits your desk, you will have just two weeks left to get your submission(s) in for the 2013 Adam Smith Awards. Our simple ambition is to continue to recognise and showcase the best in corporate treasury practices as demonstrated by you, our readers.

Now in their sixth year, these Awards are firmly regarded as the industry benchmark for corporate treasury best practice and innovation. Previous winners include many of the world's leading multinational organisations as well as medium and smaller size enterprises from across the globe. They all have one thing in common. It is really quite simple. They have each implemented solutions that have improved their respective treasury functions; in many cases taking them to an entirely new level.

So, if you have recently completed a project that has transformed your business, nominate yourself, your team and your company. There has never been a better time to showcase your accomplishments, to profile the value your treasury function brings to your company and share your achievements with your peers.

We have added some new categories in 2013:

- Best Foreign Exchange Solution
- Asia Pacific Regional Award for Best Practice
- Treasury Today Woman of the Year

This last category is part of our Women in Treasury initiative. We know from our experience operating in this market there are some truly outstanding women who act as an inspiration for all in the treasury profession. So why not nominate yourself, or nominate another female treasurer who has inspired you in your career.

Wei Shi, VP Head of Treasury and Finance at Toyota Financial Services and winner of the Top Treasury Team 2012 told us:

"It was an honour to receive recognition for the work we have been doing. Treasury is sometimes seen as a 'black box' and we were able to use the Award to show not only our Toyota colleagues but also our external investors the value of what we do. It also led to us being asked to make a number of industry presentations which was great for the public profile of Toyota Financial Services while internally the Adam Smith Award has boosted morale within the team.

2013 is shaping up to be another tough year and we'll be back again to try and win more accolades but the competition will be tough. The Adam Smith Awards shine a spotlight on those treasuries that have had the foresight – and courage – to implement best practice processes and solutions. If you have done something interesting in the last year I encourage you to join us in entering. The more of us that enter the more we can learn from each other and recognise the enormous value that treasury brings to the business."

## Enter now

If you have submitted an entry in previous years please do not be dissuaded from entering again this year. Alternatively, if you are a newcomer to these Awards please view this as an opportunity to showcase the projects you are working on within your treasury department.

We look forward to receiving your nominations – which can be made by completing the simple entry form at [treasurytoday.com/awards](http://treasurytoday.com/awards). The celebratory lunch for Award winners will be held at Plaisterers' Hall in the City of London on 20<sup>th</sup> June.



## Corporate investments: still safety first

Research by Treasury Today indicates that security and liquidity remain top priorities for corporate investors – with yield coming in a distant third. Corporates want to keep cash relatively short, liquid and visible.



**Diane S. Reyes**  
Global Head of Payments and  
Cash Management  
HSBC 

HSBC's Diane Reyes, who has held many roles within the transaction banking industry over the past 20 years, believes that the secret to her success has been due to execution, commitment and reputation. Once you have proved yourself on the first two, the third follows.

**Andreas Liebenow**  
Treasury Processing Manager



Henkel had more than 1000 bank accounts with over 140 banks globally, many accumulated via acquisitions. It needed greater visibility and control over its entire banking structure and "wanted to see all balances of all accounts on a daily basis, at the press of a button."

The only solution was a web-based, bank owned solution and Citi's TreasuryVision liquidity portal stood out.



## A blank canvas

Building a treasury from scratch can be a career-defining moment. A successful job proves that you have the ability to manage a complex project, have a thorough knowledge of treasury issues and can perform well under stress. By creating a roadmap, treasurers have a greater chance of making sure that the goal of best practice remains in place, even if it can't be achieved at the outset.



## REGULATION

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### Crunch time

Efforts to develop a single accounting standard by converging IFRS and GAAP have been trundling along for more than a decade. Is the end goal in site? Or is this just an incredibly bad time to ask corporates to react to a big change in accounting rules?



## CASH MANAGEMENT

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### Running in the family

SWIFT has been working hard to create a more inclusive environment for corporates. In addition to its connectivity pipeline, SWIFT has developed SWIFTRef for reference data, 3SKey for security, eBAM for bank account management and supply chain products TSU and BPO explicitly aimed at this segment of the market.



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**Michael McGovern**  
Group Treasurer



Now in his 35<sup>th</sup> year at the Irish Dairy Board, Group Treasurer Michael McGovern comments on the ability of the company to withstand economic fluctuations, as seen in Ireland over the past few years. The crisis had more effect on the company's financing structures than on its actual business.

## THE BANK INTERVIEW

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**Bruce Proctor**  
Global Trade Head

**Bank of America**  
**Merrill Lynch**

Bruce Proctor is joined by the bank's regional heads of trade for a roundtable discussion on key trade issues for the coming year, including estimations on how far the renminbi (RMB) will progress as an alternative currency.







“Nominations for the 2013 Adam Smith Awards close on 30<sup>th</sup> April. If you have not yet submitted your entry, don’t delay, now is your final chance to share your unique success story and win a coveted Adam Smith Award. Regardless of your company size, industry sector or location, this is your opportunity to showcase how you and your team have overcome challenges to achieve cutting-edge solutions through best practice and innovation. I wish you every success.”

Carole Berndt, Head of Global Transaction Services for Europe, the Middle East and Africa at Bank of America Merrill Lynch.

**This page contains an edited version of a Treasury Insight piece written in the last month. The full versions of Treasury Insights are posted on [treasurytoday.com](http://treasurytoday.com) as they are ready. The Treasury Insights weekly email summarises the new pieces from that week plus other news relevant to treasury. You can register for this free service at [treasurytoday.com](http://treasurytoday.com)**

## SEPA: still in the starting blocks

At a SEPA conference in Frankfurt last month, representatives from corporates, banks and technology vendors gathered to discuss the challenges they are facing in meeting the 2014 deadline. Treasury Today was there to report on the proceedings.

There was one particularly revealing moment during the morning session of the Countdown to SEPA (Single Euro Payments Area) Conference, hosted by EuroFinance in Frankfurt in March. About halfway through a panel discussion concerning the state of corporate readiness for the February 2014 deadline, the Chair, Erik Mansson, Independent SEPA Consultant from Mindshift Consulting and ex-Deputy Secretary General at the European Payments Council (EPC), interjected to conduct a quick straw poll of the corporate representatives there in attendance.

"Can all of you who have started your SEPA Credit Transfer (SCT) project and are on track, please raise your hands?" A nervous chuckle then rippled across the room as four or five of the 110 corporate delegates present lifted their arms.

"That's certainly an image," deadpanned Mansson. "Now, let's see the result for SEPA Direct Debit (SDD)." Unsurprisingly – to those aware of just how problematic migration to SDDs has proved – the number of positive responses was smaller still.

The response seemed to roughly reflect the results of an earlier EuroFinance Peer Group Survey supported by Deutsche Bank, of 140 corporate treasurers presented just moments earlier. With less than one year to go until the migration deadline, corporate readiness on SCT and SDD is still minimal – currently around 30% and 2% respectively, the latest EPC data suggests. Considering just how little time remains and the complexity of the challenge, large numbers of corporates apparently have not even started their projects yet.

According to the survey, 37% of corporates have either not started migrating to the SCT yet or are still in the planning stages. The picture painted by data on the SDD side is even more worrying. As the end of 1Q13 approaches, only 49% surveyed say they have begun – and are on track with – their migration.

So, how did such a significant number of businesses end up in this predicament?

Rob Palmer, Treasury Development Specialist for the UK-based optical retailer Specsavers, began by explaining how relieved he was that his company was not the only latecomer to the migration project. Specsavers, he said, didn't receive much information from its software provider to prepare for the looming deadline.

In fact, it was only when its banks began communicating about the deadline situation in the latter half of 2012 that the company began to fully grasp the nature of the challenge that lay ahead, Palmer admitted.

"Therefore, we are in the early stages of looking to incorporate SDDs and SCTs across our stores in the Netherlands, Spain and Ireland."

Ariane Van der Eecken, Group Treasurer for Telenet, a Belgium cable operator, told the delegates that her company, like many Belgium-based organisations were early starters in the SEPA migration project and are part of the 30% currently using SCTs. As a big biller, the company successfully migrated to SCT for incoming payments in early 2009, modifying the payment slip on outgoing bills. However, outgoing payments were not as straightforward. Van der Eecken explained the company was keen to proceed immediately to the next stage, but the project proved to be more complex than was initially envisaged, which meant delaying its migration until 2Q13.

### Is there a third way?

Third party technology vendors such as CGI must be looking at the current state of affairs and anticipating a lot of business coming their way as the end-date draws closer.

"Yes, I imagine there will be a mad dash of corporates looking for help in the final quarter of this year," Garry Young, Director of Corporate Services for CGI's IP Solutions Business, told Treasury Today. In fact, requests for proposals are already starting to come through the door, he adds.

One thing is becoming clear: if the experiences of those companies who have already begun the transition are anything to go by, those corporates who have not yet begun implementing solutions are going to have a lot of work to do over the next 11 months to achieve compliance before the deadline. The clock is ticking.

**A longer version of this article is available at [treasurytoday.com/2013/03/sepa-still-in-the-starting-blocks](http://treasurytoday.com/2013/03/sepa-still-in-the-starting-blocks)**

# This much I know

**Diane S. Reyes**

Global Head of Payments and Cash Management

HSBC 

## What is your career-defining moment?

I've had a number during my 20 years in transaction banking, but one that really sticks out was winning a significant, landmark mandate. The deal had taken almost three years to come to fruition and at that time was the largest of its kind. It really confirmed my belief that if you're persistent, if you have the vision, if you stick with it and continue despite the hurdles put in your way, then you really can be a change agent and deliver a company-altering proposition. That deal resulted in hundreds of people being hired and helped our business operate on a larger scale. I believe this single experience positioned me very well for the roles I have since had.

## What do you think is the secret to your success?

I would say my ability to execute, which requires persistence, determination and an absolute focus on effective communication. Trust and reputation are also attributes which I value tremendously and I call upon these frequently in my current role, whether I am dealing with my executives, management team, business partners or, importantly, clients. Over the years I have developed a reputation for delivering on my commitments, this is something that is very important to me.

## Which women in business most inspire you and why?

Rather than identify specific women by name I would identify particular traits I find inspiring, in both men and women. I like managers who are not afraid to voice their support – people who are willing to take a risk on another individual by sponsoring or mentoring them. I am a big champion of this as I've seen women in the past dissuaded from pursuing their careers through a lack of support. I think men seem to be doing a pretty good job on this front – going out on a limb for people coming up through the company – and I would like to see women do more.

## What is the biggest challenge you're facing just now?

Banking in general and transaction banking, particularly in the cash management arena, are experiencing profound changes, within both the industry and the global economy. Our major challenge is to maximise opportunities given the economic trends. It's about bringing our capabilities to the table when our clients need them and delivering our solutions in a proper and sustainable way. We need to ensure we work with clients to identify their needs, and to deliver real benefits.

## What couldn't you manage without?

I would say 'support', and this comes in three key areas: Family support; management support; and an excellent talent base. I have four children, and as a mother you can't really have the type of global job which requires you to be out of town a lot on business and have a family that doesn't support your decision. The second line of support is the excellent management team here at HSBC – particularly my two senior executives as I have dual reporting lines and access to them, and their support, is critical. Third, is the talent base the Bank has. You need a world-class team in order to deliver the goods, particularly given the scale of our cash management business. So I would say family support, management support and top talent.

“In this day and age, treasury is an overall contributor to the firm, rather than a support function. In many ways it's an ideal career path for women as treasurers who want to contribute to the bottom line and it plays to women's skillset.”

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## ON THE WEB

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To read all the interviews in this series go to [treasurytoday.com/categories/women-in-treasury](https://treasurytoday.com/categories/women-in-treasury)





## What is your next major objective?

I am just 18 months into my role here so I still have quite a bit I want to do. We need to substantially grow the business and do this in a sustainable and suitable manner for both the firm and our clients. I need to ensure we continue to remain relevant to our clients and the market. When I talk about remaining relevant I also mean we need to continue to innovate with a real focus on developing cash management solutions, such as electronic or mobile options.

## What advice would you give to other women in treasury?

This is an excellent time, if I look at it from a corporate perspective, to be in treasury. A large part of the strength that women have is in their ability to deliver, to understand the subject matter, and the details of the business. In this day and age, treasury is an overall contributor to the firm, rather than a support function. In many ways it's an ideal career path for women as treasurers who want to contribute to the bottom line and it plays to women's skillset very much. Women can easily establish their contribution, for example, to the earnings per share for their firms. I would advise and counsel women who have an interest in the financial industry that this is such a great moment for them to be in treasury.

## What are your views on mentoring?

I am very passionate about mentoring. If someone were to ask 'where would you spend some of your non-specific day-to-day job hours?' it would be on mentoring and sponsoring women and trying to see how much of an impact I can make in that regard. I was asked to sponsor an HSBC initiative called the Accelerated Career Progression Programme and it has exceeded my expectations. Its focus is on mid-level women and how we prepare them for the next step in their careers, where they can make a difference at the senior level. Mentoring and sponsorship are really critical to bringing women up in the firm, giving them the flexibility to make career shifts. It's really incredibly important.

## If you weren't global head of payments and cash management what would you be?

I am very early in my role at HSBC and I am committed to getting the job done. That being said, the only other path that I have considered is a government role. When we think about regulators around the world and what they are facing right now, a lot of their future changes will require people with the type of background and experience in matters like systemic risk for example, that I and other colleagues in the banking industry have.

## A day in the life

A day in the life of Reyes entails spending a great deal of time supporting both external clients and customers. After this interview, Reyes was heading off to visit one of HSBC's top ten clients in the US.

"They are in the middle of trying to decide whether they're going to implement a new product solution, how they're going to do it and with whom. So we're going to have a discussion in a very unique fashion, actually, in what we call storyboard fashion as opposed to a traditional PowerPoint. I can help them in their decision, to talk through how the implementation could work."

She also spends an equal amount of time internally with the relationship managers in HSBC's global businesses that Payments and Cash Management supports – Global Banking and Markets, and Commercial Banking. The relationship managers in these segments work with clients ranging from multinationals to mid-size customers who are growing internationally. "I spend a lot of time, both with my colleagues and with their clients to ensure I'm meeting evolving new market needs, resolving client issues or developing new product solutions for clients."

Reyes stresses that she does not do all of this personally, but supports when her team needs her, for example to provide input on major new product developments, or when HSBC needs to design global training programmes for its employees. "We have programme management meetings to monitor our progress on initiatives and product commercialisation. We colour code the progress of our reports to make sure we're ready to deliver for our clients." ■



Diane Reyes considers herself a career transaction banker. After college, she made a concerted decision to get an MBA that would enable her to get into a more "career-oriented role." Before completing her MBA, she started looking around at firms in the Pittsburgh area and was impressed with Mellon Bank's reputation in the cash management field.

"I thought it was a great opportunity to apply some of what I had learned in the MBA programme. It was a combination of being in the right city, with Mellon having a great reputation and then being in the right business programme."

Reyes has been in transaction banking for over 20 years, moving to J.P. Morgan and Citi before joining HSBC about 18 months ago. She moved from product management roles to running the global sales team at Citi. Her job spec has also changed through the years. She now has a much more global role, which she finds very exciting and challenging. At HSBC, Reyes spends a lot of time managing her team of globally based staff. "We've spent a lot of time on how we are positioning ourselves for success in the current and expected future environment, working with our clients and offering our global proposition."

# Commodity price risk

“ How can treasurers improve the quality of their cash forecasts? ”

## Daniel Blumen, Partner, Treasury Alliance Group:



The best way to improve cash forecasting is to evaluate the current process against five best practices of cash forecasting.

1. **Simplicity.** A cash forecast requires two pieces of accurate information; the amount of cash on hand and the amount to be received net of expenses. Add the dimensions of time and currency; when will the cash be received, and in what currency and you have a reasonable and very effective cash forecast. When asking business units to forecast cash, keep it simple. Don't ask for a detailed weekly flow of funds report requiring forecasts of inter-company receipts/payments, loans/investments and third-party receipts/payments.
2. **Cooperation.** Good quality forecasting input is the primary determinant of a good quality forecast. And the quality of the input is in the hands of your business partners. Building trust is an important step in this process. If forecasting accuracy is used as a punitive tool by treasury, units will hedge forecasts and refrain from sharing key strategic insights, diluting their value.
3. **Communication.** Forecasting in a global company adds the challenge of multiple currencies, language and culture. It is critical that all business units adopt common definitions in the cash forecasting process. Cash in bank ledgers and available cash are two different concepts, familiar to treasury associates but less familiar to accountants or others involved, so make sure everyone completing the forecasts understands and uses the same definitions.
4. **Structure.** Cash forecasting problems arise when business units lose faith in central treasury's ability to respond to their urgent funding needs in a timely manner. They respond with excessive caution in forecasting receipts and even hold onto their own cash reserves, diluting the accuracy and value of the forecast. The solution is to have an efficient account structure serviced by a reliable network of banks. This can take time to develop but results in reduced administration, transaction and other costs.
5. **Technology.** You can increase simplicity, cooperation and communication with the effective use of technology such as gathering forecast information through an intranet or file-sharing site. Using an intranet adds security and administrative efficiency as well. Work with your technology team to develop a form for collecting the forecast input. These are relatively simple to develop and the data gathered this way is typically stored in a database on one of your servers. This is a winning approach from a number of perspectives; it's consistent, enterprise-wide, secure and administratively efficient.

The best practices outlined above won't get you perfection but will give you a good start.

## Paul Stheeman, Independent Treasury Executive and Consultant:



Quite often treasurers will seek to improve the quality of their forecasts by adding details to their calculations or by looking for enhanced tools such as new or better software. But do these ideas really help solve the problem?

Adding detail may lead to more complexity and have the opposite effect – ie is less transparent, more prone to errors and more difficult to understand or disentangle when questions are raised. The treasurer should always stick to the motto “keep it simple”. He should regularly review the detail and critically ask whether it is required.

A new enhanced software tool may give a false sense of security. It is the information going in which will decide on the quality coming out.

When preparing a cash forecast the treasurer will seldom amass all the numbers himself. Typically he will have to aggregate information received from subsidiaries or operations. He is dependent on the high quality of this information. Therefore the most meaningful instrument he has are his communication skills. He will need to build a framework which the people from his operations will understand and he will need to communicate with them. It is not sufficient to send an email or a spreadsheet around once a month. The treasurer has to talk regularly with the experts from operations, firstly to ensure they understand what his requirements are and why he regularly needs them. He should give these experts an opportunity to communicate back to him, for example telling him why certain numbers cannot be provided with the degree of accuracy expected or why some may be fixed and others uncertain.

The detail and complexity around cash forecasts today mean that it is essential that communication lines work well. Good relationships make it easier to pick up the phone and share information. The treasurer must have confidence in his own numbers and he can only achieve this if he fully understands them himself. He must therefore proactively build relationships with the correct people and ensure a collaborative communication style with them. He should provide feedback on each report he receives, so that the operations people can see their input is valued.



## Ryan Smith, Treasury Manager, Mitsubishi Corporation International (Europe):



Accurate cash forecasts are necessary to improve the liquidity management of the treasury function. In recent times it has become more important than ever to avoid unpleasant financial surprises and thus avert the spectre of expensive emergency funding or cash surpluses earning next to zero credit interest.

For best practice, a treasury should utilise the cash forecasting capabilities of their TMS as it will already hold the majority of the information required – for example: maturing loans, deposits, fx contracts and some future payments and receipts.

Using the TMS for forecasts will enable the treasury team, not just the individual who prepares and checks the forecasts, the opportunity to view the most up-to-date position.

The most difficult part of the process is to capture any further relevant data that should be part of the cash flow forecast. This can include:

- Accounting system data not automatically fed to the TMS
- Future business opportunities that may require additional finance.
- Unpredictable flows to/from suppliers/customers.
- To ensure an accurate forecast, the treasury team needs to educate persons within their company (or any relevant subsidiary) on the importance of providing accurate and timely information. This would include traders, accounting personnel and any other staff members whose daily business can provide the treasury team with future information of material monetary flows. Any information provided should be added to the TMS forecast (via manual entries) to provide the most accurate view of the company's future position.

Precautionary note: no forecast will ever be perfect, so the management of a company's assets and liabilities should always provide enough flexibility to allow for life's little surprises!

## Conor Deegan, Director, Cash Analytics:



The human element of a cash forecasting process should never be ignored. Challenges such as forecasting unexpected expenditure, capturing unpredictable flows and modelling external influences are common to most companies but large multi-location organisations, who are reliant on the inputs of personnel in business units, must contend with a range of other factors that can compromise the quality of their cash forecasts.

For these larger organisations the quality of the reporting output from a forecasting process is therefore dependent on the quality of information provided by each and every person involved. There is no doubt that forecasting cash movements can be problematic, even for companies with reasonably predictable cash flows, but ensuring the process is engaged with in a meaningful way by all contributors will give a treasurer comfort that the information on which decisions are based is of the highest quality.

A focus on the following areas should allow treasurers to achieve their long and short-term forecasting goals:

1. **Gain visible executive sponsorship.** Generally the requirement for a cash forecasting process will be driven at executive/board level but gaining visible executive sponsorship is an important first step on the path to successful process implementation.
2. **In-depth initial review.** Before committing to a group wide forecasting structure, time should be spent understanding the operations and constraints of each business unit. Find out if cash forecasting already takes place and whether existing resources can be leveraged for the overall process.
3. **Education.** Cash forecasting is a knowledge intensive exercise and as an investment made in 'educating' both personnel at business unit level and head office with regard to the nature of cash movements, will contribute to the quality of forecast information reported.
4. **Make it part of the day job.** Forecasting can sometimes fall outside of the day-to-day remit of contributors to the process. Ensure sufficient time is committed to the compilation and review of cash flow information for efficient and accurate benefits.
5. **Provide value to participants.** A process that relies on contributions from multiple sources but only provides value at head office level can deteriorate over time due to a lack of engagement from business units. Finding ways to provide value to business units – such as through actual versus forecast reviews – will boost the quality of the overall cash forecast. ■

### The next question:

"What is the most effective way to measure and control counterparty risk?"

Please send your comments and responses to [qa@treasurytoday.com](mailto:qa@treasurytoday.com)



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# Are a weak pound and yen here to stay?

*Japan and the UK have a few things in common. Both are islands that appear to be on a collision course with mainland China and Europe, respectively. Both economies are in desperate need of more stimulus. In both countries the head of the central bank has the title of Governor and both new Governors are expected to deliver a fresh dose of monetary stimulus. Not incidentally, that investors have pessimistic views on yen and sterling.*

Let's start with the UK. Like the US, the UK has seen rampant indebtedness in recent decades against soaring asset prices. Once the bubble burst, asset prices plunged right away and a number of British banks needed large-scale government bailouts. This in itself was bad news for the financial sector. On top of this, the economy required fiscal stimulus.

As a result, the public finances did deteriorate so much that the rating institutes threatened to downgrade the UK's credit rating. (They have done so once). The British government's response was to tighten its fiscal policy, whereas it was obvious that the weak UK economy could barely cope with this.

To compensate, the central bank has pursued an ultra-loose monetary policy. However, this has not been very successful. Real growth never emerged and stagnation is the order of the day. Especially as:

- Most UK consumers think they have taken out more than enough credit and many want to save up for their old age

– not least because UK pension funds have large deficits.

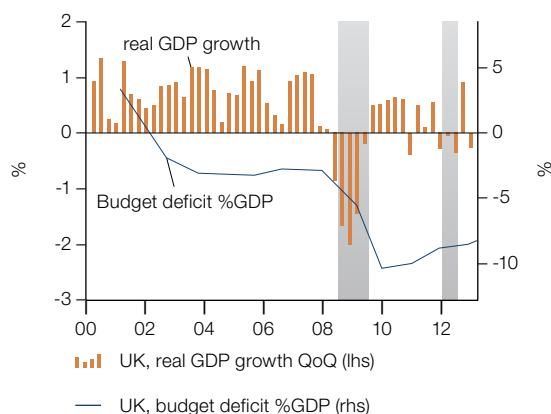
- The UK economy is very open. Wages have soared in the boom years, which is now a big problem, as the country has a large current account deficit. Presently, wages are not rising as fast as inflation, which means consumers are losing purchasing power. Plus the rest of Europe, which is in recession, is the UK's main export market.
- The UK's financial sector comprises an important part of the total economy. However, this sector was – and is still being – reorganised.

In other words, the UK too is caught between a rock and a hard place. To stop the economy from going further down the drain, the authorities are taking the following steps:

- The Bank of England (BoE) has launched a funding for lending programme. This implies that the central bank lends money cheaply to the banks, provided they use this for lending (except to the financial sector). Until now, this scheme has mainly helped to supply more mortgages, so it has not been very effective. Recently, the focus has shifted to other types of loans. This now appears to be working.
- There is constant pressure on the BoE to open the money faucets further, in order to send asset prices higher and drive down sterling.
- As to the latter, the central bank is struggling because inflation is high. This restricts its elbow room when it comes to flooding the system with liquidity (to offset the adverse effects of fiscal austerity and boost growth through asset inflation). It is hoped that a depreciating pound (GBP) will help the export sector. This would boost growth but the problem is that many other countries are also trying to weaken their currencies – for the same reason.

**Chart 1: UK Real GDP versus budget deficit**

**The UK has emerged from its double-dip recession last year but the deficit remains a major concern**



Source: Thomson Reuters Datastream/ECR

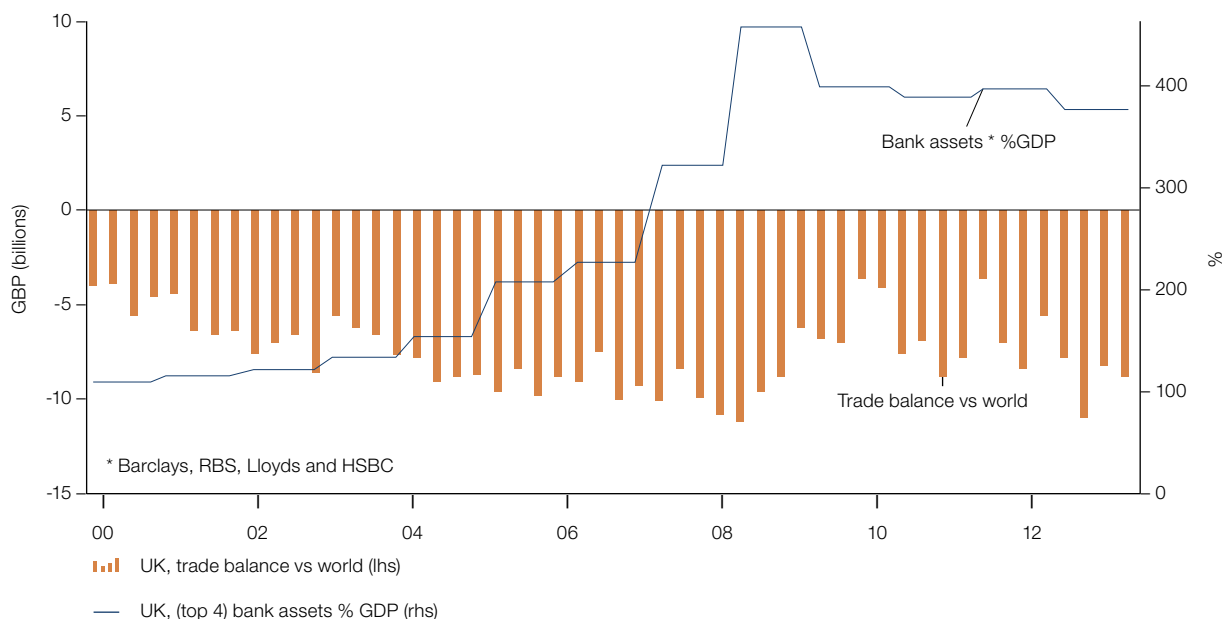
## Japan: from deflation to inflation?

In Japan, the elephant in the room is deflation, which increases the debt burden. At first glance it would seem that Japan has plenty of latitude to open the monetary floodgates.



## Chart 2: UK trade balance and bank assets

UK economy vulnerable as competitiveness is declining while size of banking system remains worrying



Source: Thomson Reuters Datastream/ECR

This is misleading as its public finances are spiralling out of control, while the country has a large national debt and budget deficit. Nevertheless, the Japanese administration intends to expand its budget deficit in order to kick start the economy. This is a dangerous strategy, especially as the population is ageing rapidly, which will undermine the public finances.

In other words, there is a high risk that the markets will think that Japan is monetising its budget deficits. Such a policy amounts to a deliberate erosion of the purchasing power of the yen (JPY) at home and abroad. As a result, borrowing costs could start to skyrocket, which would be calamitous to the government finances. Fortunately, things have not reached that point yet; lately, interest rates have dropped. In the immediate future, we can expect the following factors to influence Japanese interest rates:

- The Bank of Japan (BoJ) will purchase more bonds and, in all likelihood, longer-dated bonds as well.
- The external value of the JPY will not quickly be eroded, as many other countries want cheaper domestic currencies as well.
- The same goes for the internal value, due to persistent deflation. The government wants to achieve 2% inflation as rapidly as possible but virtually no one thinks wages in Japan will rise substantially. As a result, higher prices will

eat into consumer spending power. Such a drag on the economy will cap inflation.

Of course, everything will change if the Japanese start to borrow against rising asset prices. As in the US, it would be much better if Japan would quickly implement structural measures, so growth could improve on a permanent basis. However, this is unlikely in view of the systemic failure of politics in Japan, where a stalemate has been in place for years. Like the UK, Japan is putting all its money on one horse: the depreciation of the JPY. The other side of the coin is that Japan needs to import most of its raw materials – this will become more expensive as the JPY continues to weaken.

At the time of writing, both the JPY and GBP have shown a substantial decline against the dollar (-10% for the JPY; -8% for the GBP). After an upward correction, both currencies are expected to depreciate further against the dollar as a result of more monetary stimulus and subdued growth prospects due to high debt levels. In addition, the dollar should strengthen further.

On a relative basis, US growth prospects are better than those in Europe or Japan. This will attract more capital inflows to the US. Furthermore, the Federal Reserve will face growing pressure to tighten monetary policy to avoid a surge in inflation. This will contribute to an expected rise in USD/JPY toward 120 and a fall in GBP/USD to 1.35. ■



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# Corporate investments: still safety first

*Despite large sums of cash on balance sheets, treasurers are remaining cautious when it comes to investments. In the current volatile economic climate and with a spate of regulatory changes on the horizon, research by Treasury Today indicates that security and liquidity remain top priorities for corporate investors – with yield coming in a distant third.*

Corporate investment decisions have always been influenced by three overriding objectives – security, liquidity and yield. But in recent years, the first two of these objectives have become paramount and yield has taken a backseat. Since 2008, companies have become increasingly conservative and risk-averse. Above all, they want to be able to convert their investments back into cash quickly to meet any unexpected demands or needs. And remarkably, this precedence has persisted even in an environment with burgeoning sums of cash on corporate balance sheets.

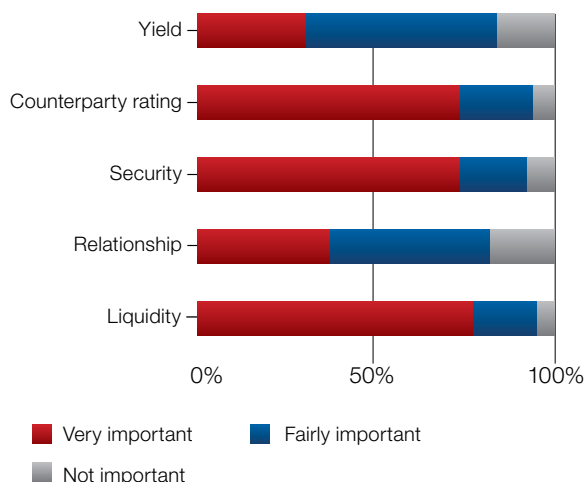
The trend is clearly represented in Treasury Today's European Corporate Treasury Benchmarking Study published in 2012.

In Europe, the vast majority of respondents (79%) described liquidity as a “very important factor” when making investment decisions, and for security the figure was 76%. Meanwhile only 28% of the corporate professionals surveyed considered yield to be a very important factor.

## Beyond yield

Alex Riseman, Head of Liquidity Solutions, EMEA at J.P. Morgan Treasury Services, thinks the results of the 2012 Treasury Today Corporate Treasury Benchmarking Studies are a reasonably accurate reflection of what he has witnessed over the past five years with respect to the bank's clients.

**Chart 1: How important are the following factors when deciding investment policy?**



Source: Treasury Today European Corporate Treasury Benchmarking Study 2012

According to him, they are keeping more in their liquidity buffer and looking to short-term investments in order to optimise liquidity. And although investment guidelines will always dictate security and liquidity as the priorities, that doesn't necessarily mean that yield is entirely irrelevant.

"There is always a need to balance security or safety of principle with liquidity and yield. But I think that if you look at what has happened since 2008, there has been a definite sea-change where security has become even more important than it was previously," Riseman says.

"That is really the number one priority for our clients – they are always going to be concerned about capital preservation above all else. Basel III is also having a significant influence, while making banks stronger than ever and creating a more consistent funding structure, it can also uncover new earning opportunities for clients' operating cash."

## Once bitten, twice shy

Although security and liquidity have always been priorities for corporates when it comes to investments, yield was not always considered to be quite such a subordinate factor for businesses when making investment decisions.

The situation in the immediate aftermath of the global financial crisis gives an inkling as to why this is. Today, the caution many corporates are showing with regard to investments is widely believed to be a symptom of the trauma that lingers from that period.

Before the world of banking descended into chaos in September 2008, many corporates enjoyed trouble-free access to revolving credit facilities from their banking partners. Banks would extend lines of credit to their corporate clients, who could, in return for a commitment fee, draw down on the facility when needed and repay the money when they reached a net-surplus cash position. But when the US sub-prime mortgage sector crisis began to spread across the globe, banks began to batten down the hatches.

"Corporates found that they couldn't use those facilities in the immediate aftermath of the crisis," says David Whelan, Director of Treasury Services at Capita. "Banks said if we are not able to fund your draw down, then you cannot use the facility – regardless of the agreement that was in place or the fact that they had been using them to date."

Corporates were quite understandably disturbed by what had followed in the aftermath of the crisis. They began to look at ways to diversify their funding base and reduce their dependence on traditional bank finance. As bank lending declined, asset finance, and particularly corporate bond issuance, skyrocketed. In 2009, \$1.5 trillion of debt was issued by companies in the capital markets – a record which would eventually be surpassed three years later in 2012.

## Cash stockpiles begin to grow

One consequence stemming from this determination to reduce their dependence on the banks was that companies began to build up large sums of cash on their balance sheets. Since the crisis, treasurers have been consistently increasing their cash balances in every economic quarter, as indicated in the 2012 Liquidity Survey by the Association of Financial Professionals (AFP).

In September 2007, exactly one year before the collapse of Lehman Brothers, UK non-financial corporate cash deposits stood at £622 billion. Just five years later, in September 2012, the corresponding figure had increased by £50 billion to £672 billion.

**"Corporates now have less trust in the banks to be available when the going gets tough."**

David Whelan, Director of Treasury Services, Capita

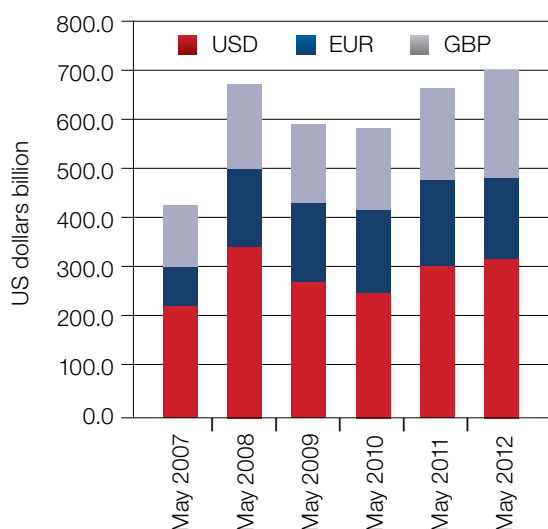
Although this trend has caused a large degree of consternation – among shareholders, politicians and the press – others, like Whelan, see it as a natural, understandable reaction by companies to what they experienced after 2008. "Corporates now have less trust in the banks to be available when the going gets tough," he says. "A CEO of a big business such as British Airways, for example, would say that they know these facilities are available once again, but they want to make sure that the credit lines are there when they want to draw down on them. If the CEO has a programme for capital expenditure which needs to be executed they don't want to be told they can't access the facility because the bank, or the country where the bank is based, is suffering."

This may also explain why there is such a pronounced level of aversion from companies to seek ways of securing better returns.

But there are ways that banks can help clients to get better returns on the cash sitting on their balance sheets without compromising security and liquidity. One of the ways J.P. Morgan is doing this is through a product it has developed called the Liquidity Management account. With this product the bank looks at the value of the cash over its duration, returning some of the yield that it sees from the long-term value of



**Chart 2: IMMFA money funds - assets under management (US dollars equivalent)**



Source: iMoneyNet

operational cash back to the client. "It gives the clients benefits in a number of areas," says Riseman. "From a security point of view the deposit is on J.P. Morgan's balance sheet, which clearly helps them, but it also gives them the yield that comes as the balances stay with us over time as well as the liquidity that comes with leaving balances in an operating account."

The bank is also developing other products that Riseman says will secure better returns for clients on their cash balances. It is not just yield that clients are concerned about, he says. Many of the bank's customers are also looking for ways to manage down their fees and increase their operating margins. "We are looking at developing solutions in which clients can use their operating balances to offset their fees – either locally or on a global basis," Riseman adds. "When you are looking at returns, yield is not the only factor, so we are also looking at enhancing the ability of our clients to improve their operating margins as well."

"I think that is exactly the way we approach clients nowadays and how clients see the banks," adds J.P. Morgan's Wilco Dado, Head of Cash Management, EMEA, Treasury Services. "We basically say, bring the business with you and because it is linked nightly with operational balances, this type of product can give the client – maybe not better yield – but better overall return on the liquidity through a better pricing on the payment fees."

## Money markets since the crisis

In order to preserve their capital corporates in Europe, the UK and the US have also been increasingly turning to money market funds (MMFs), as a means of avoiding losses through inflation, but importantly, without compromising safety or liquidity.

MMFs have always been centred upon stability of principle as their main objective, says Ed Baldry, CEO, EMEA, at ICD-Portal, a software-as-a-service (SaaS) platform investors can use to analyse money markets. "I've been in the MMF business for over 20 years, and it has always been security as king, liquidity as queen and yield as the aspiring prince," he says.

The popularity of MMFs has not been significantly diminished by the lack of yield. Baldry explains that currently in the AAA prime money fund space there is a range between 2bps and 18bps. In euro, the yields are even more marginal, ranging between zero and 4bps. But despite the emphasis of corporate investment strategies moving away from yield, MMFs remain a useful tool for corporate investors. "Effectively since 2008, when we had the Lehman Brothers meltdown and the beginning of the crisis, we could have completely removed the yield column altogether from our website and 80% of our clients wouldn't have noticed," he says.

"The focus has very much gone away from the yield on the funds. I would say that in terms of the stability of the funds, the astute corporate treasurers are – from a best practices standpoint – looking further into what they own. For virtually all of the large corporates, financial institutions – and anyone else using money funds via our platform – their focus is on the security of principle first and foremost."

## The looming regulatory challenge

There seems to be little possibility of the corporate investor's current focus on security and liquidity changing at any time in the foreseeable future. Whelan says that Capita's forecast for the next few years reveals that the UK and Europe will remain on the verge of recession until at least 2015 – if not descending fully into outright recession.

"The focus has very much gone away from the yield on the funds."

Ed Baldry, CEO, EMEA, ICD-Portal

Furthermore, with the challenge of new regulatory standards for banks and other financial institutions looming on the horizon, the corporate investor's job of finding the right balance between security, liquidity and yield, is not likely to become any easier. Most of the new regulatory changes in the financial sector – Basel III, Solvency II and the EU Green Paper on Shadow Banking – are concerned with ensuring that banks and other financial institutions put aside additional capital as a buffer to cover losses in the event of another crisis on the scale of September 2008.

These impending changes will inevitably impact the way in which corporate deposits and investments are handled, says Whelan.

"Banks and other financial institutions will change in order to reflect what the regulators are saying they now need to do in terms of shoring up and putting aside additional capital," he says. "I believe that this will lead to these institutions seeking longer-term and stickier deposits. And I'm sure the corporate market is quite ready to make that leap. They still want to keep cash relatively short, liquid and visible."

"I think it will be really interesting to see what happens next," he adds. "How the structure of the market is going to change as a consequence of these new regulatory pressures and demands, and how the corporate customer base of these banks and financial institutions will react to that." ■



**Andreas Liebenow**  
Treasury Processing Manager



Henkel is a leading laundry and home care, beauty care and adhesive technologies company. The company, headquartered in Düsseldorf, Germany, was established in 1876. It now has subsidiaries in over 75 countries with more than 47,000 employees. Global sales of over €16.5 billion stretch across a portfolio including a number of global brands such as Persil, Schwarzkopf and Loctite.

## Problem...

Henkel had more than 1000 bank accounts with over 140 banks around the world, many accumulated via acquisition. Although it had been using a single database (containing all account numbers, SWIFT codes and so on) to maintain accounts worldwide, it had no centralised bank account statement collection and no group-wide ERP. The onset of the financial crisis drove the company's senior executives to seek a way of establishing greater visibility and control over Henkel's entire banking structure. In essence, says Henkel's Treasury Processing Manager, Andreas Liebenow, "we wanted to see all balances of all accounts on a daily basis, at the press of a button". Given the economic environment, it also wanted this structure in place with minimal delay.

Having formed a requirements definition, Henkel's project team studied the market closely for a solution. Although integration of balance reporting into the company's existing SAP ERP and Wall Street Systems TMS would be the ultimate aim, it was deemed at the time to be an overly resource-intensive solution. Buying in a separate software solution would also require commitment to a major implementation effort, with considerable costs likely. The only other option was to deploy a web-based bank-owned solution.

## ...Solved

In this respect, one offering stood out: Citi's TreasuryVision liquidity portal. "From the beginning we felt good with Citi," states Liebenow. Henkel already had around 20% of its accounts with Citi but TreasuryVision, with full data warehousing and reporting functionality, would be taking in MT940 electronic account statements from all of the group's banking partners. This solution had never been implemented in Germany before but it was live with more than 120 corporates globally. "We never once felt like we were the guinea pig," states Liebenow.

With a dedicated and experienced Citi implementation manager and solid technical support in place, Henkel was provided with template forms and information packs to send, via all treasury locations, to each of its banks. The form requested daily MT940s from every account to be sent to Citi. With Liebenow supervising account feedback, TreasuryVision was tailored to fit Henkel's data structure.

Within a couple of months, 80% of the group's liquidity, representing the most important accounts, was visible within TreasuryVision. In the second wave, some 'less-sophisticated' third-party banks have been unable to submit MT940s in the correct format. With Citi's support Henkel has either been working with them directly on a case-by-case basis to implement a work-around. In some cases Henkel finally opted to manually input their balance information into TreasuryVision. As new accounts are opened (and others are taken on through acquisition) all must be reportable via MT940. And with all local subsidiaries now paying to maintain multiple accounts, it ensures each is justified. Liebenow reports that almost 150 accounts have been either closed completely or moved to a bank that can accommodate MT940s. The total number of bank relationships has been reduced by 14.

"The most important benefit is that we now have liquidity status on a daily basis whenever we are asked," notes Liebenow. "It does not matter if we are asked for a region or for a company or for the whole group; we have the answer." This "positively completes the project"; anything else – such as improved counterparty risk management and faster response to industry and economic change – is a welcome add-on.

Henkel has implemented a rule of zero cash for its affiliates. Cash pools are kept in the regions with most liquidity – the biggest Asian countries, North America and Europe. It also requests a quarterly report on the use of guarantees and credit facilities. With greater control over all accounts, facilitated by TreasuryVision's capacity to drill down into account data, funds retained by affiliates must also now be justified and checks can be made on their use. Improved head office oversight promotes the prudent use of funds, becoming almost a self-regulating process, Liebenow commenting that it has indeed "encouraged changes of behaviour".

Plans are afoot to build an interface between TreasuryVision and the Wall Street Systems TMS to enable automated reconciliation of net financial debt and daily financial status reporting (currently manual processes). There is also a plan to integrate credit facility reporting. None of this would be possible without Henkel first having established implemented TreasuryVision. As Liebenow comments, "this is an excellent result so far and there is a lot of future potential". ■



# A blank canvas

*The idea of building a treasury from scratch is a thrilling prospect. However, having a blank canvas in front of you can be a bit like standing at the edge of a cliff – the first step is a big one. How can treasurers avoid the pitfalls and implement a best practice treasury?*

Given the opportunity, not every treasurer would jump at the chance to set up a treasury from scratch. It requires different abilities than those in the day-to-day treasury skillset – including project management skills which the average treasurer doesn't necessarily have. In addition, it usually involves much smaller companies than most treasurers would be accustomed to, admittedly ones that are growing either organically or through M&A activity, or private equity/venture capitalist carve outs.

However, being involved in a greenfield project has many upsides. A treasurer can be seen to be 'earning their stripes' in the profession, effectively proving their mettle. A successful job proves that they have the ability to manage a complex project, have a thorough knowledge of treasury issues and can perform well under stress. Plus a greenfield site allows them to unleash their creativity and sculpt a department to their own specifications. That in itself may pique a treasurer's interest.

For those that take the plunge, it can be a career-defining moment – although not necessarily a career-enhancer, according to Mark Adamson, Owner, Mark JD Adamson Ltd. He believes that it is easy to get pigeon-holed into either a "run-and-maintain" treasurer or a "get-it-done" project manager, and over time it becomes more difficult to cross back over to the other side.

But for Bas Rebel, Senior Director, Corporate Treasury Solutions, PricewaterhouseCoopers, building the European treasury centre from scratch for Perkin Elmer, a US multinational technology corporation, shaped his career and contributed to his professional success. "I think it is a career-defining project for a treasurer, especially today when treasury is at the crossroads of either remaining a tactical contributor or becoming a strategic value driver."

Ever since the crisis in 2008, the CFO has prioritised cash visibility, getting a grip on cash flow and finding alternatives for



bank funding – all of which are in the treasurer's domain. "The new treasury should be a custodian for cash and risk, and to some extent compliance," he says. "The treasurer who contributes to these areas makes a strategic contribution to the company. This brings them into working capital management and financing. They also have to define how to work with core businesses to make this happen. If you do it right, then the world is your oyster."

**"It is a career-defining project for a treasurer, especially today when treasury is at the crossroads of either remaining a tactical contributor or becoming a strategic value driver."**

Bas Rebel, Senior Director, Corporate Treasury Solutions, PricewaterhouseCoopers

## First steps

It is hard to pinpoint the first step to take in building a treasury. Adamson's advice is to get to the bottom as to the reason a new treasury is being set up. "This is not an insignificant event, as treasurers are senior individuals in organisations and do not come cheap. Hence, there must have been a trigger event – good or bad. I think that the first thing that the new treasurer has got to understand is what the trigger event was, which will tell reams about the new landscape and the tone of the organisation. I am not sure that this would necessarily come out in an interview process if they hired externally."

He lists a few negative scenarios for implementing a new treasury, such as investors wanting more influence in the operational executive side of running the business as a result of a control incident, in addition to the more positive scenarios listed above. A new treasurer will need to dig beneath the surface to understand what has instigated their appointment.

This groundwork will also serve to understand what the culture of the treasury will be. Previously, the discussion was whether treasury was a cost or profit centre; however it is less of a black and white discussion today and must be done in collaboration with the directors and executives of the business.

The next step is to understand treasury's remit and scope of activities. For example, at the larger company end of the scale, a treasurer might be responsible for investor relations, insurance and pension funds, as well as day-to-day treasury activities such as refinancing and managing currency exposures. In smaller organisations, treasury might only be responsible for cash management. However, some companies may include accounts receivable (AR), accounts payable (AP) and credit control – treasury can fill many gaps in a company's requirements, as most treasurers know from experience.

As part of developing the target operating model and working out treasury's remit, according to Karlien Porre, Treasury Advisory, Deloitte UK, the treasurer will also need to answer questions dealing with the size of the treasury team, the quality and level of people required, IT infrastructure, controls, etc. This is the time to ascertain whether the company has the in-house

skills to run the project itself, or whether it needs to look for external support.

Developing treasury policy is the next hurdle. The treasury policy is a reflection of the company's risk appetite and business objectives – for example is it looking to grow quickly or conserve existing assets? It is important to engage with the CFO, finance director and also tax and legal advisors, particularly if looking at jurisdictions outside of the home country. Tax and legal considerations are big drivers when deciding how to structure the treasury department, for example where to put staff and keep cash, and which entities to use for certain functions.

This should not prove to be too difficult, says Paul Stheeman, an Independent Treasury Consultant. "With a little bit of experience in using or writing policies, you can use the framework for what you are doing now," he explains. He stresses the importance of being fully aware of the company's overall risk appetite before beginning to draw up the policy.

A critical thing to keep in the back of your mind when creating treasury from scratch, according to PwC's Rebel, is the question: what do you want to be when you grow up? "It is important to think in terms of where your company wants to be in five or six years' time and plot what you need to do to get there. Don't think too much about what your capabilities are today because you first have to align your strategic goals to the goals of the company. Only when you have defined the strategic targets/contribution of treasury, can you start plotting what type of expertise you need to have, what your policies have to entail and what functionality is needed to make that happen. It is a top-down approach: strategy, organisation, policies and then systems."

Once treasury has defined a roadmap, it can then start discussing with management, subsidiaries and banks as to what they can do to help it reach its end goal. "Using this method you can pose open questions, rather than asking closed questions or squeezing out an extra penny. By describing what you are trying to accomplish, you will receive input from the other side of the table, which helps to identify value-driving opportunities that you may not have thought about before. In the end, you will build better relationships," says Rebel.

**"The perils of implementing a new treasury is similar to other large projects, the first being scope creep."**

Karlien Porre, Treasury Advisory, Deloitte UK

## Avoiding implementation pitfalls

The perils of implementing a new treasury is similar to other large projects, according to Deloitte's Porre. The first is scope creep. "Although you start out with an initial plan outlining what treasury should cover, as time goes on your scope – whether operationally or systemically – gets expanded and delays or derails the project. Therefore, sticking to your defined scope is quite important." Commitment of funding and resources, both quality and quantity, is an area which often causes delays in projects. Another pitfall is changes in the leadership or steering committee of senior management driving the project.

The new management may not agree with past decisions, leading to a review which could change or delay a project.

Drilling down into more treasury-specific hurdles, Adamson argues that impatience can be an issue. “Directors have made a decision at a Board meeting that the company needs a treasurer, so they have gone through an extensive – and expensive – job search and recruitment process, and hired a treasurer. Monday morning when they turn up, the treasurer is at their desk and the directors relax, thinking that the job is done. The reality is that it has only just started. And, perhaps, it is worse than they think because the treasurer, with their specific skills, is going to perhaps find out more than the directors actually knew before.”

Through dialogue and relationship building, the treasurer plays an important role in ensuring other executives in the company understand that the implementation of a treasury or treasury solution is not an overnight activity. “They need to understand that they are starting a journey, there will probably be some mistakes along the way and it will take some time before the treasury department is in the desired state that the business needs it to be in. It depends on size of company but from walking in on a Monday morning to feeling that something controlled, secure and rational is in place is a two-year timeline,” says Adamson.

Brian Welch, Managing Director, UserCare Treasury Consultancy Limited, agrees that directors and the finance department might have heightened expectations as to what treasury can deliver immediately, but he adds that they also may not have any idea as to what to expect from treasury. Either way, there is usually a lot of education to be done from the outset.

Stheeman’s advice at this point is to be prepared for the unexpected. “You will often find that you are being caught wrong-footed, for example a bank may suddenly question credit lines; or you may have to settle an FX transaction when you don’t have sufficient records or settlement instructions; or someone signs off a payment without sufficient authority. At the beginning, you just don’t have the routine in place that you will have after a few months and therefore the unexpected is bound to hit you at some stage.”

## Implementing best practice

Despite each company – and the countries they operate in – exhibiting unique features, there is a far greater degree of best practice in treasury than everyone tends to believe, according to Rebel of PwC. But a treasurer must define best practice upfront in order to be able to aim for it. The extent to which best practice will be achieved is another thing. That is also dependent on external constraints (such as legislation, regulation, etc) as well as internal constraints (such as resources and budget).

This comes back to Rebel’s point about creating a roadmap. “Try to be bold and don’t assume that things are impossible. Once you have decided ‘what you want to be’, then you have a benchmark for a gap analysis. Any compromise will be transparent and documented. In addition, when you get into the territory where you have to make compromises, you come up with the right reasons why you want to make those compromises and you can explain it. But if you pick a point on the horizon with implicit assumptions about what is possible and what isn’t, then you will be challenged as to whether you have thought about this or that.”

By creating a roadmap treasurers also have a greater chance of making sure that the goal remains in place even when it isn’t immediately achieved. “It comes back to commitment to the initial scope and model. You shouldn’t stop striving for best practice when you have something up and running in six months to a years’ time, but should continue with the plan and improvements,” says Deloitte’s Porre.

It is so much easier to get a poor treasury function set up on the basis that it will be sorted out later, but Adamson believes that it is a false start. However, it takes a certain type of person to hold out for best practice. “It takes mental strength and stamina to implement best practice without compromising,” he says. “Maybe best practice implementation is painful, but if we want to do it we should do it now and not set up a compromise solution that is revisited and reworked in the weeks and months to come. It is possible to do but it takes a certain strength to do it – which doesn’t necessarily fit in with regular day-to-day treasury activities.”

Stheeman is more pragmatic. “In treasury you should have a vision about how the future treasury function will operate, which will include having appropriate policies in place and staff, but at the outset you are not likely to have either. You will have to move forward gradually. You should keep best practice as a goal but not make unrealistic expectations or shortcuts to a first-in-class treasury operation,” he explains.

## Measuring success

Performance measurement is always difficult in treasury, according to Welch. Gone are the days of volatile interest rates when treasurers could benchmark their return on surplus cash. “Although we do try to identify benchmarks, it is one of the most difficult things in treasury, mainly because objectives can differ depending on the company,” he explains. For example, companies may have different ways of measuring foreign exchange (FX) achievement in terms of the impact of FX and foreign currency on their results.

When setting up a new treasury function, the action plan should include completion deadlines and relevant comments to each particular item, so that it is possible to regularly track progress. For example, a company may decide it wants to incorporate x% of its accounts into a cash management structure, then at the end of the year it can see whether it has captured x% of cash in the treasury centre, thereby minimising interest cost and optimising interest earned.

But Adamson believes that looking at just financial metrics jumps over an important dimension. “You should measure and record control incidents – or ‘near’ control incidents – which every business and treasury department has to differing degrees. This should be done on a ‘no blame’ basis, with lessons learnt, understood and disseminated. Therefore one measure of success is whether the number of control incidents has stabilised or gone down.”

The third important area is staffing engagement, which many treasurers ignore. “If you have come in as a new treasurer and your staff is turning over every six months, then that is a sure indication that it isn’t a nice place to work. You will have absolute chaos on your hands if you are constantly re-recruiting and retraining. This softer measure around staff turnover, training, knowledge and contentment is something that you need to think about. In my experience, with a good team of people you can achieve great things,” says Adamson. ■



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# Alfred Marshall

*Alfred Marshall belongs to an elite group of economists – Adam Smith, David Ricardo and John Maynard Keynes – who left a profound and permanent mark on the history of economic thought. His great achievement was to further our understanding of microeconomics to such an extent that even today his ideas are familiar to anyone who has taken an introductory course in economics.*

Like many of the great economists, Alfred Marshall has sometimes been a victim of mistaken and superficial characterisations. The image which dominates today is of a dreary 19<sup>th</sup> Century mathematician. A man who lived completely in the thrall of mathematics and an advocate of a rigid strand of economics that sought to reduce all market interactions into abstract graphs and equations.

But this particular caricature is rather unfair on the founding father of neo-classical economics. Marshall did indeed give birth to what Maynard Keynes referred to as “diametric economics” – that is the representation of concepts as simple graphs. But his interest in the science stemmed principally from moral considerations, above all, his desire to help the poorest in society. In contrast to a number of his contemporaries on both the left and right, Marshall did not think of economics as a zero-sum game in which some people had to endure severe poverty for others to prosper. He believed that in a perfectly formed, competitive economy, living standards should rise for everyone. He promoted the theory that competition begets innovation, which in turn leads to greater productivity and drives up wages. Hardly a ground-breaking idea today. But in the era in which Marshall first expressed it, the theory was truly revolutionary.

## Background

Marshall was born in London in 1842. He came from a middle class background, although he was not particularly wealthy or privileged. His parents believed strongly in the value of education and endeavoured to send him to reputable schools. His father was said to have been keen for him to excel in theology, classics and languages. Marshall, however, was drawn to mathematics. Resisting his parents' ambitions for him to join the ministry, Marshall became a student of mathematics, along with philosophy and political economy at St. John's College, Cambridge. His academic interests began with a focus on metaphysics – that is “the philosophical foundation of knowledge” – before moving to the study of ethics and a specific variant of utilitarianism. In 1868 he became a lecturer of political economy at St. John's, and began his career-long work of developing the subject and helping to transform it into a new science – economics.

His interest in ethics continued to shape Marshall's thinking. Indeed, if you read Keynes' famous obituary of Marshall, it seems ethical concerns were one of the original motives behind his decision to become an economist. In the eulogy Keynes wrote for his former Cambridge tutor, he recounted how Marshall was moved by his walks through “the poorest quarters of several cities... looking at the faces of the poorest people”.

So, economic theory appealed to Marshall principally because he saw it as a means to improve the conditions of the working classes and create a fairer, more equitable society.

In 1877, Marshall was forced to leave Cambridge following his marriage to Mary Paley, a student in his political economy class, which contravened the university's regulations. However, he would return to Cambridge less than a decade later to take the chair as Professor of Political Economy in 1884, where he began working on his most influential work *Principles of Economics*. The book, published in 1890, had a profound influence on the study of economics in English speaking countries, helping to establish Marshall as the pre-eminent economic thinker of his day. Marshall retired from academia due to ill health in 1908, although he continued to write prolifically even after he had stepped down. His last two major works were *Industry and Trade*, published just following the end of the Great War in 1919 and *Money, Credit and Commerce*, a collection of older, unpublished essays and ideas published in 1923.

## Contributions to economic theory

No feature on Alfred Marshall would be complete without a brief explanation of his most notable contribution to economic thinking – the supply and demand curve. Marshall's attention as an economist was focused on the workings of individual markets and industries in isolation, and largely ignored the question of how entire economies function. Unlike his contemporary Leon Walras, who pioneered analysis of the interrelationships among all markets, in Marshall's work the impact one market has on another market was not taken into account. With this approach, he laid the foundations of what economists today refer to as “partial equilibrium analysis”.

Marshall's basic argument was that prices would always be forced towards their equilibrium by the nature of competition. If prices were below their equilibrium then shortages inevitably result, and as companies begin to sell out of the particular goods, this will put up the price and increase production. Conversely, if the price of the given product is above the equilibrium level then the companies selling the product will see their inventories swell. In these circumstances, the rational response for business is to lower prices and cut production. However, Marshall recognised his supply and demand chart was not, by any means, a simple construction and hence required a more detailed explanation.

Demand, he argued, was governed principally by utility – that is the satisfaction a consumer receives from the purchase of a good. In a market, consumers are perennially attempting to

acquire the greatest level of utility from the products which they purchase and consume. As a result, whenever confronted with a decision of what to purchase, consumers compare the utility which they receive from one purchase with that which would result from an alternative. When the price of a good is very high, sales are typically lower because consumers recognise that they can get greater utility by buying a larger quantity of lower priced goods.

A shift in the supply and demand curves occur when consumers purchase more or less of a good when the price remains the same. Marshall identified four main factors which he thought could create shifts in demand:

1. Wealth.
2. Changes in taste, growth or decline in population.
3. A change in the price of other goods.
4. Expectations about future prices.

Firstly, if the wealth or the size of the population increases then demand will naturally increase too. Secondly, tastes may change as a result of advertising or because of a certain event – for a recent example of this we need look no further than the recent scandal involving horsemeat in beef products, which according to recent reports has altered the buying habits of around 60% of consumers. Thirdly, the public suspect prices to rise in the future then that will also stimulate demand as people rush to buy products at their current lower price. The final factor is a change in the price of another product.

The impact that Marshall identifies is rather complex. If the price of say, an electric guitar, increases, other goods will in most cases rise. However, there are some examples in which this does not happen. One is with respect to ‘complimentary goods’ that is, goods which are often bought or consumed together. So, to return to the example of the guitar – an amplifier manufacturer may well experience a dip in sales if the prices of guitars went up, and consumers would buy fewer guitars and hence have less need for an amplifier.

Supply is instead controlled by the cost of production. Producers will always attempt to maximise profits in much the same way as consumers strive to maximise utility. But the law of diminishing returns acts as the constraining factor on production – an increase in production inevitably means an increase in costs – the supply curve is positively sloped to

reflect the fact that businesses will only produce more goods if they receive a higher price. Again, Marshall identifies that supply can shift and that more or less goods are produced and sold at each price.

The main factor causing supply to shift is a change in the cost of production, for example higher wages. If wages are forced up – say through negotiation or legislation such as a minimum wage – the only way for a business to make the same level of profit is to put up prices and pass the cost on to the consumer. An increase in the costs of production, therefore, will inevitably push the supply curve to the left.

## Emergence of corporations

It was at the beginning of the second industrial revolution when Marshall began developing his economic theories. This was a time of great economic upheaval in the UK. The typical business organisation in England during the 19<sup>th</sup> Century was the small firm owned and managed by families and partnerships. But as the new century approached, this type of company was beginning to give way to a new type of business – the big corporation. New technologies helped the development of large-scale economies and this in turn helped to pave the way for professionally managed businesses in which the ownership resided with shareholders.

This raised a question that had been troubling economists since the era of Adam Smith – namely, can increasing returns be reconciled with competition?

Marshall did not see the decline of the family run business and the emergence of corporations as necessarily a monopolistic threat to competition. As Jaques Kerstenetzky explains in an article published in the Cambridge Journal of Economics in 2010, Marshall’s view was that increasing returns were an unavoidable facet of competition, although something “neither accessible to all firms nor instantaneously accessible to any firm”.

Marshall recognised large companies would become more widespread in the 20<sup>th</sup> Century. But rather than nostalgically arguing for a return to the model of the small family-owned business of the Victorian era, he instead focused his attention on analysing the monopolistic tendencies of this type of organisation and exploring theoretically how regulation could be used to keep such ambitions in check. ■

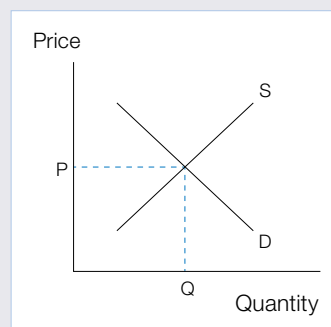
## Supply and demand

Like John Locke and David Ricardo before him, Marshall was aiming to develop a theory that comprehensively explained pricing and value. To understand how prices worked in individual markets he analysed supply and demand and ascertained that the relationship between the two market forces could be expressed as a simple chart.

- The *law of supply* is represented by the upward sloping curve. When prices increase companies respond by producing more, thereby increasing the level of goods available on the market.
- The *law of demand* is represented by the downward sloping curve. If prices fall then consumers respond by purchasing more of the given product.
- The natural price of a good (or market equilibrium) is where the two ‘scissors’ intersect.
- Marshall’s analysis differed from the value theories of Jevon (demand driven) and Ricardo (supply driven) in that he argued prices were determined by both supply and demand, not one factor alone.

The theory rests on three basic principles:

1. Individuals have rational preferences between different outcomes.
2. Individuals attempt to maximise utility, while businesses wish to maximise profits.
3. Consumers act independently and with all the correct and relevant information – cases in which this last principle is not the case are referred to as ‘market failures’.





# Grass roots treasury

**Michael McGovern**  
Group Treasurer



The Irish Dairy Board (An Bord Bainne in Irish) is the country's largest exporter of premium dairy products and a leading international food company with a global footprint extending to over 90 countries. Group Treasurer, Michael McGovern, tells Treasury Today about the changing face of the dairy industry and the pleasures and responsibilities of working within a co-operative.

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*The Irish Dairy Board (IDB) has annualised sales in the region of €2 billion. Headquartered in Dublin, the business employs 3,300 people globally and has successfully established routes to market for Irish dairy produce into Asia, Europe, the Middle East, North America, Africa and China.*

*A co-operative enterprise, IDB is owned by Irish dairy processing co-operatives and dairy companies and, through them, by Irish dairy farmers. On behalf of its members, IDB is engaged in the purchase, marketing, and sale of consumer dairy products and dairy food ingredients worldwide through its subsidiaries and extensive network of agents and distributors. Consumer dairy products are marketed primarily under the Kerrygold, Pilgrims Choice, MU and Beo brands, and the consumer division activities are supported by cheese packing facilities in the UK and butter packing in Germany. The Dairy Trading and Ingredients division sells and trades products across the globe and its facilities include powder blending and packing in the UK and ingredient cheese processing in the UK and US.*



With subsidiaries around the world and an international growth strategy, one of the primary responsibilities for treasury in the Dublin-based treasury headquarters of the Irish Dairy Board (IDB) is cash management, using cash pooling and cash concentration accounts. It also arranges financing for the group, provides funding via the pooling system, and carries out all FX hedging. Fundamentally it is, says Michael McGovern, IDB's Group Treasurer, a "traditional group treasury function".

McGovern is in his 35<sup>th</sup> year with IDB and one of the biggest changes he notes over this time concerns the volume of currency deals and the spread of the business to more overseas locations. "We used to do an awful lot more foreign exchange (FX) dealing," he explains. Until January 2002, the Irish punt was the base currency which was hedged against the US dollar and sterling, as well as Dutch guilders, German marks, French francs and so on. With the introduction of the euro (naturally IDB's base currency), the amount of hedging required drastically reduced and now the only currencies hedged are US dollar and sterling, with most sales outside Europe being transacted in dollars.

However, new offices will be opening soon in Russia and in Saudi Arabia and with others in the pipeline this will bring new FX requirements and cash management challenges. The expansion of IDB's markets has seen an increasing need for more sophisticated technologies to facilitate the necessary degree of treasury oversight, but the raised level of automation has enabled the operation to level out at its current complement of four full-time professionals.

## Finding funding

The EU's milk market is currently regulated by a quota system in which every member state has a national production quota (split amongst its farmers). Exceeding the national quota triggers a penalty called a 'super levy', which is paid to the EU. The EU decided in 2009 that by 2015 the quotas will expire and milk production will effectively be liberalised. IDB, which is expecting a production increase in Ireland of some 50% by 2020, has developed a growth strategy which will open up new routes to the markets and for that, having the right financing structure in place, says McGovern, is "absolutely critical".

IDB is well-positioned to withstand economic pressure. Ireland may have been facing serious issues over the past few years, but as an exporter with a broad reach (all of its product goes abroad one of its biggest markets being Germany) it has been fairly well insulated against domestic trouble. And not only is Ireland an attractive tax-regime (the corporate tax rate is 12.5% and hence the reason many overseas treasury functions have re-located here), IDB's basic product line is a food staple and therefore unlikely to be cut from the typical consumer's shopping list.

"The crisis has impacted us more on our financing structures than on our actual business," notes McGovern. Although the banks – particularly the international players – are very keen on IDB's business, because it is based on a staple food and it is all exported, it has been necessary to put in more committed facilities. "Banks are much more comfortable with asset-backed structures," he concedes. The global financial crisis caused some of these institutions to withdraw from the relationship, despite 30 or more years of continued business. McGovern is philosophical, accepting that the international banks that took this decision were facing their own problems at a head-office level and indeed some are now back in the fold. The continued support from its banks is something

McGovern is very aware of and is something that informs current bank selection policy: "we strive to give an equal share of wallet to those banks that are now in our structure."

## Fair play

It comes as little surprise that McGovern's team is "very conscious" of monitoring these relationships and that the emphasis is on fairness. "You need to give them the ancillary business to warrant them lending to you, but I think all treasurers are looking at the same thing; they're lending to us and supporting us, so quid pro quo, we do our utmost to support them."

In terms of its own funding requirements, instead of going to the bond markets, IDB, based on its current funding requirement, will continue to rely on its banks to provide debt (it currently has a €160m revolving credit facility with its panel of banks). "We did a private placement in the 1990s when we bought our US subsidiaries," says McGovern. "Obviously we keep in touch with the private placement market and if we require long-term funding we would consider its value to us as an add-on source of funding."

IDB members, which number ten of the largest Irish dairy processing companies, do get good support from the banks, but they also have access to credit through IDB as well. This currently comes in the form of invoice discounting, a scheme that has recently been established with IDB's panel of banks to open up "good, solid credit" and an easier (and cheaper) source of working capital for the Irish dairy industry.

The scheme is based on a finance deal involving a three-year reverse invoicing discount facility of €190m. This is an innovative facility in that it is a syndicated and termed arrangement, with Rabobank leading and HSBC, Barclays, RBS, Bank of America Merrill Lynch (BoFA Merrill) and AIB also on-board (the same panel of banks that offer "some good healthy competition" to meet IDB's FX needs). Although €190m is not a large sum as syndicated deals go, there is extra capacity for IDB to increase it should it be needed, with a possible extension being sought later this year.

## Need for more sophisticated technologies to facilitate the necessary degree of treasury oversight.

"We've designed a web portal for our members," says McGovern explaining the delivery model. The portal, a development by IDB's own IT team, places the emphasis on ease of operation, with no extra software required by the supplier; all that is required is a secure login. In practice, having delivered the product and invoice to IDB, the supplier can then link to the participating banks via the portal, indicating which invoices it wishes to sell. IDB verifies that these invoices are bona fide, and the supplier can immediately receive funds from the bank, with real-time updates delivered to the supplier at each stage. IDB will then settle the relevant invoices, paying the bank directly according to the original credit terms. The supplier pays the market rate for the advance funds, but that rate is based on the superior credit-worthiness of IDB. In essence, the creditor stays the same, explains McGovern, but

the beneficiary of the creditor becomes the bank, and so it is not bank debt on IDB's book. The simplicity of the system means it is now "working like a dream".

## Using IT

Technology has an increasingly important part to play in modern business and McGovern believes one of the crucial roles in treasury today is to look after IT, assuring the treasury perspective is always heard when changes are implemented. "With the way it is going, a lot of the treasury processes are IT-driven. If you don't have someone with treasury experience and IT knowledge I think you will be lost," he comments.

Given its currency requirements, IDB is a committed user of the 360T and FXall trading platforms and it also has Misys' Confirmation Matching Service in place. "There's a lot happening on the processing side and we automate as much as we can," explains McGovern. One of his main tools is IT2's treasury management system (TMS), "a very decent system". Since the acquisition of that vendor by Wall Street Systems in January this year McGovern has noted no impact, adding that it is still perhaps too early to feel either benefit or drawback.

The systems and goals of the IDB treasury function are "very much in line" with those in regular commercial structures.

One of IT2's major developments in the past year has been the migration of all of its desktop functionality into the mobile environment for those that want it. Is the prospect of taking treasury decisions on-the-go a cause for celebration for IDB? "Not really," says McGovern. "For looking at positions, it may be useful. But as for processing anything through it, I'd be a little bit worried about that."

## Getting connected

One service that has made its mark is SWIFT messaging. IDB has embarked on a "big project" to get itself connected. Having worked with one cash management provider (BoFA Merrill) it is now splitting the function three ways: BoFA Merrill will retain North American operations; RBS will undertake European operational accounts; and HSBC will provide an overlay multicurrency pooling system. "Because of that, we're going to access all our banks via SWIFT's Alliance Lite 2 structure," says McGovern. "This allows us to be bank-agnostic and gives us greater flexibility to reach out to different banks as we increase our footprint."

IDB currently operates a notional pooling system in Europe and cash concentration in the US. Following the deployment of SWIFT connectivity this will change to a zero-balance pooling system with the multi-currency cash pool residing with HSBC. McGovern accepts that the shift to three cash management banks will lose some of the single-bank efficiencies. He sees it as part of a trend internationally amongst treasurers to move away from the single provider, but the main driver is to give IDB more flex and allows it to "share the wallet" with its banks.

Without a flow of deposits right now that would warrant the use of money market funds (MMFs), any cash excess is

deposited by IDB amongst its syndicate of banks. The policy is one of going for "safety and not yield". In this respect, although he often has banks knocking on the door to pitch for business, McGovern states "we'll always keep the door open". Sometimes it is best just to say no. "Some years ago I had a visit from BCCI which was offering huge yields," recalls McGovern. "We didn't trade with them, but they gave us a clock as a memento of their visit. A few months later they went spectacularly bust. Anytime anyone comes in talking about great yields, I always take a glance at the BCCI clock." The bank's failure in 1991 cost depositors more than \$10 billion, according to The Economist.

## A co-operative treasury

The systems and goals of the IDB treasury function are "very much in line" with those in regular commercial structures. "We strive to be a world-class treasury and it's always our goal to be up there with the best," states McGovern. "We're not as big as some but the processes are no different from other treasury departments."

In this respect then, regulatory impositions can be just as much a nuisance to IDB's treasury as they can be to any other. "Know Your Customer (KYC) regulations make me mad," McGovern complains. Whilst the fundamental idea is sound, in practice, from his perspective (and probably that of most other treasurers), it fails to assess where the risk is. "For example, I've lost count of the number of times we've had to deliver passports of the same people into the same banks – how does their passport expiry change someone's identity?" They should, he says, "be risk-profiling not box-ticking".

But fraud is an ongoing concern for most treasurers and McGovern is no different. Although IDB no longer uses cheques, he observes that cheque fraud is still a problem, especially in the UK. "The US has the Positive Pay system to combat it; when a company writes a number of cheques it sends a file with all the details to its bank and the bank will only clear when the details match. In the UK that doesn't exist and yet cheque fraud is huge. I can't understand why that system is not used."

Electronic fraud around payments is much more of a direct threat. IDB has witnessed it first-hand, fortunately with no loss, and retains a number of measures to thwart such attempts. However, McGovern believes more could be done to help curtail the efforts of these "very innovative" criminals, not least by the banks and the authorities.

The Single Euro Payments Area (SEPA) is something that is much talked about by banks and treasurers alike, and IDB has been ready for some while with all its IBANs, BICs and other system requirements in place. "We're ready for SEPA, so what's keeping SEPA?" McGovern asks. When it does finally fall into place he feels SEPA will benefit IDB, not least in being able to execute more centralised payments.

In fact, the whole cash management reorganisation of IDB will bring more centralisation to treasury processing and this, along with getting the financing structure in place, particularly with the EU quota changes coming, will consume much of McGovern's time over the coming months and years. But then with the co-operative to keep happy, and moves into new markets and countries already being planned, he is never likely to let the grass grow under his feet. ■



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# Crunch time

*2013 is being viewed as a crunch time for all number crunchers – from auditors to accountants and treasurers. Developments in the regulations governing the preparation of accounts will have far reaching consequences for all. Yet there are a number of outstanding questions that still need some answers before the dust settles.*

Corporates today are experiencing a degree of ‘uncertainty fatigue’, as they have waited for more than a decade for the convergence of the two main accounting standards – the International Financial Reporting Standards (IFRS) and the US Generally Accepted Accounting Principles (US GAAP).

The corporate number crunchers want the rules to be laid out so that they can take the necessary measures to become compliant.

“I think the corporate community just wants clarity. They have been waiting for a long time and now want a standardised accounting model so they can start adjusting their systems and get on with it,” says Mark Vaessen, Global IFRS Leader at KPMG.

Since the signing of the Norwalk Agreement in 2002, the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have been working towards converging the standards. Most of the short-term and several of the longer term convergence projects have either been completed or are nearing completion.

A single international accounting standard, however, will not signal the end to this journey. Its implementation will be watched closely by many, and future reviews will no longer involve just the FASB and IASB but the rest of the world.

## Where do things stand now?

Convergence has been achieved for revenue recognition accounting and accounting for leases, but there have been “some challenges to developing completely converged solutions, especially for the impairment and insurance contracts project,” stated the IASB and FASB in their joint update in February.

The IASB is making limited amendments to IFRS 9 Financial Instruments, while the FASB is proposing completely new guidance, and as such, their exposure documents will differ.

The joint project to improve financial reporting on financial instruments is being conducted in three phases:

1. Hedge accounting.
2. Expected credit loss accounting.
3. Recognition and measurement of financial assets and liabilities.

For financial instruments, both boards have eliminated differences in their respective classification and measurement models, and have converged standards on contractual cash flow characteristics assessment, business model assessment,

fair value through other comprehensive income and fair value through profit or loss.

## Impairment or loan-loss provisioning

Overhauling the accounting for financial instruments has been the most important phase to date and aims to develop a more forward-looking provisioning model which recognises expected credit losses on a timelier basis. Currently, both standards use an incurred loss model to determine when impairment is recognised on financial instruments, which entails a loss event to take place before a provision can be made. This model was criticised following the financial crisis as it delayed recognition of losses and failed to reflect accurately credit losses that were expected to occur.

In a March statement, IASB Chairman Hans Hoogervorst said: “We believe the model leads to a more timely recognition of credit losses. At the same time, it avoids excessive front-loading of losses, which we think would not properly reflect economic reality.”

All entities that hold financial assets that are not accounted for at fair value through net income and are exposed to potential credit risk would be affected by the proposed changes covering loans, debt securities, trade, lease and reinsurance receivables, loan commitments and other receivables.

While the aim continues to be a converged standard, the extent of future convergence will depend, in part, on feedback. The boards spent time in developing a three-bucket impairment model, but after considering views by stakeholders, the FASB decided to modify its proposal to include only a one measure approach – the current estimate of contractual cash flows not expected to be collected on financial assets held at the reporting date. The IASB will maintain the ‘three-bucket’ approach but it will be revised to address concerns on which lifetime expected losses should be recognised.

Both proposed models remove any threshold for the recognition of expected credit losses and the information used to estimate and measure this is consistent for both models. The FASB has published a separate document for public comment on an alternative expected credit loss model. The comment deadline for IASB’s draft is 5<sup>th</sup> July and for FASB, 30<sup>th</sup> April, with deliberations expected to be completed in 2013.

## Hedge accounting

The IASB’s move to improve hedge accounting by aligning it more closely with a company’s risk management activities is

not a joint project with the FASB. The FASB, however, has sought comments from its stakeholders on IASB's Hedge Accounting Exposure Draft but has not yet begun deliberations, in conjunction with feedback on its own proposals.

The IASB, on the other hand, has agreed to grant relief from the requirement to discontinue hedge accounting where a derivative is required by law or regulation to be novated to a central counterparty (CCP). An exposure draft has been prepared with a comment deadline of 2<sup>nd</sup> April (see page 30).

## Leases

Lease obligations are widely considered a significant source of off-balance sheet financing and the aim is to improve financial reporting by both lessors and lessees by recognising leases on the balance sheet.

For capital/finance leases, the IASB and FASB decided to provide specific transition relief for existing finance, capital, sales-type and direct financing leases. Both bodies will publish exposure drafts on lease accounting in the second quarter of 2013 and jointly redeliberate the proposals later this year. As with impairment, the timing of the issue of final requirements will depend on feedback.

## Revenue recognition

The aim is to create identical standards on revenue recognition and to clarify the principles that can be applied consistently across various transactions, industries and capital markets.

Both Boards completed the substantive redeliberations of the recognition and measurement principles in December 2012 and plan to take another look at the remaining topics, which include the scope, disclosure, transition and effective date, in 1Q13 and issue final standards in mid-2013, according to the joint report.

## Insurance contracts

Both Boards acknowledge the difficulties in reaching convergence for insurance contracts, blaming this on the different starting points – the IFRS currently does not include accounting requirements for insurance contracts, while the FASB is proposing amendments to its own longstanding insurance model.

They have reached different decisions on the model, including recognition of changes in estimate, inclusion of a risk margin in the measurement of liability and the treatment of acquisition costs.

The IASB decided to seek feedback on only five key issues:

1. Treatment of participating contracts.
2. Premiums presentation and claims in the comprehensive income statement.
3. Treatment of unearned profit in an insurance contract.
4. Presenting, in other comprehensive income, the effect of changes in the discount rate used to measure insurance contract liability.
5. The approach to transition.

The IASB plans to publish this in the first half of 2013, whereas the FASB is targeting mid-2013.

## Investment entities

Although the investment entity project was, in most part, jointly deliberated by the IASB and FASB, the final requirements will be similar but not identical. The IASB issued final requirements in October 2012 and the FASB will issue a final standard in the first half of 2013.

The FASB is addressing the accounting for investment entities more broadly than the IASB. Joint deliberations on the feedback will commence later this year.

Philippe Danjou, IASB Board Member, has tried to clarify some misconceptions on the convergence in Europe. He says the IFRS do not require – nor are there plans to require – all assets and liabilities to be stated at fair value, and notes a mixed model used under IAS 39, will be maintained under IFRS 9. Also, he says, for derivative financial instruments, there are hedge accounting provisions which neutralise any volatility when the use of derivative instruments is part of a hedging strategy and its effectiveness can be demonstrated.

## Will the US embrace IFRS?

KPMG's Vaessen says the key question going forward will be whether there is enough political will in the US to adopt IFRS. "It has proved very difficult to make decisions with the two Boards trying to agree on everything."

Despite this, IFRS is accepted in more than 100 countries and, as such, considered to be the global standard setter.

"Large international companies in the US are in favour of IFRS. They have reporting obligations in numerous countries and it is cheaper if they can do it as a group. They will have less reconciliation and bookkeeping to do. Whether you are a treasurer or an accountant, it is easier if just one standard is used."

"Obviously US companies with a more domestic focus are reluctant to switch to IFRS. The transition would be costly, so they need to know what the benefits are."

The global economic uncertainty has resulted in a focus on costs, especially in the US where there are other new regulations such as the Dodd-Frank Act. Therefore, this may not be the best time to ask for a big change in accounting rules.

Vaessen does not think a decision will be forthcoming soon. "The expectation now is the US will not decide until perhaps late this year or early next year, at the earliest."

Gurpreet Banwait, Product Manager at derivatives and hedge accounting solutions company, FINCAD, agrees that although there is some convergence, the official convergence is probably still many years away.

So what will happen if the US decides against adopting the IFRS? "It will be unfortunate. But we would still have one world with two standards," Vaessen says. However, there is a risk that in the absence of a US decision on the adoption of IFRS, a decade of convergence may be followed by a new period of divergence.

On whether China, Japan and India will embrace IFRS fully, Vaessen believes this is very likely. "A US decision would certainly push other countries to decide. Even if the US decides not to proceed, I believe China, Japan and India will in the end choose IFRS."

The three countries have already made significant moves towards IFRS but have yet to adopt the standards fully, with China and India adapting the IFRS to their own needs.

## Challenges going forward – application of the standards

The next challenge going forward for the accounting community will be the consistent application of the IFRS globally.

“Despite it being in only one language, so to speak, there are a lot of different dialects. People are coming to the international standards and are sometimes pushing for their own interpretations.

The IASB set up the Standing Interpretations Committee in 2002 (renamed IFRS Interpretation Committee in 2010) to interpret and

“provide timely guidance on financial reporting issues not specifically addressed in IAS and IFRS”. Vaessen questions whether the committee is geared to handle all these enquiries.

The committee recently changed its approach so as to handle more issues but it still needs to step up, especially on the already converged standards and even more so if the US were to come on board.

“There will however be a limit in terms of giving guidance. With principles-based standards, you have to leave room for professional judgement under the particular fact and circumstances, rather than try to give guidance for every conceivable fact pattern. The latter approach runs the risk of ending up with rules, rather than with principles, which would be undesirable. So, overall it is a matter of finding the right balance,” concludes Vaessen. ■

## Hedge accounting

The IASB’s Novation of Derivatives and Continuation of Hedge Accounting’ proposes changes to IAS 39 and the proposed chapter in IFRS 9 to allow hedge accounting where hedging instruments are novated to a central counterparty (CCP) in line with laws or regulations introduced on over-the-counter (OTC) derivatives.

The European Market Infrastructure Regulation (EMIR) was passed in 2012 but technical standards on OTC derivatives, reporting to trade repositories and requirements for trade repositories and CCP took effect on 15<sup>th</sup> March 2013.

Hedge accounting in a treasury environment could lead to reduced volatility in profit or loss. However, the rules as they stand now are complex and time consuming, with onerous documentation requirements, says Amit Bhana, Manager, Capital Markets Division, Deloitte South Africa, where he heads the hedge accounting function for the IFRS Advisory Service Line.

The changes proposed in IFRS 9 include:

- Hedge accounting to be aligned to risk management activities.
- Removal of the requirement for a retrospective test, although a prospective test is still required.
- The threshold for hedge effectiveness testing being removed – replacing the current quantitative requirements and arbitrary bright lines for assessing hedge effectiveness with a qualitative assessment on the basis that ensuring the hedging relationship results in an unbiased hedge, with a second requirement that the hedging relationship achieves more than accidental offset.
- Proof is required of a correlation between hedged item and hedging instrument.
- Hedge ratios could be rebalanced to improve hedge effectiveness.
- Risk components of non-financial items can now be hedged.
- Relief is provided for hedging with options.

Treasuries should consider how this will impact their hedge accounting processes and their financial statements, says Bhana. “The application guidance remains complex in some areas, and significant cost and effort may be needed to analyse the requirements and determine how best to apply them. To complement a more principle-based approach, additional disclosures will be required of how a treasury is managing its risks.”

The changes are intended to align the presentation of these risk management strategies with the way that treasurers run their business. Designating hedging relationships without careful consideration of the entity’s documented risk management strategy may result in the entity not achieving hedge accounting. The changes aim to reflect all hedging-related activities in other comprehensive income.

“Ahead of IFRS 9, treasuries should review their current risk management and hedge accounting policies. It is expected that existing hedging relationships will continue to qualify under IFRS 9. However, the criteria to achieve hedge accounting will be significantly different compared to IAS 39, particularly with effectiveness testing. Potentially, hedge accounting can now be applied to relationships that were not possible under IAS 39,” says Bhana.

Finally, treasurers should assess their treasury management systems (TMS) and departmental readiness. Additional system and data requirements include the ability to track rebalancing of hedge relationships, measurement of risk components of non-financial hedged items and hedge effectiveness assessments with more statistical rigor.

Fincad’s Banwait warns if corporates apply all these new charges from EMIR and Dodd-Frank, then this may impact non-financial organisations using derivative contracts to reduce their risks.



# Running in the family

*SWIFT has been trying to engage with the corporate community for many years and yet membership has remained relatively low. By restructuring and bringing together core payments messaging and trade services functions, it hopes to generate a more inclusive environment for businesses, banks and vendors alike. What does the new structure look like and what does it mean for treasurers?*

By pulling cash and trade together, André Casterman, the new Head of Corporate and Supply Chain Markets for SWIFT, hopes the bank-to-bank, corporate-to-bank and now the corporate-to-corporate sectors will become one happy family. This structural realignment within the co-operative took place in December 2012. "We've followed the trend of global banks: pulling the two closer together into a transaction banking unit," he explains, which gives more visibility to the not-always-easy-to-comprehend business of trade finance. The new approach is based on four pillars, the first relying on the core SWIFT offering of multi-bank connectivity for its 1000+ corporate members.

For those corporates that are multi-banked and which wish to have a channel (whether direct or via a service bureau) to reach their banks, SWIFT remains "the proven value proposition". But there is more, states Casterman. "In order to increase the quality of payments and decrease the number and cost of rejections by banks, we have now extended our reference data product, SWIFTRef, to corporate users as well."

SWIFTRef is a central repository of data built around payments reference codes and updated on a monthly basis by SWIFT. International Bank Account Numbers (IBANs) and Bank Identifier Codes (BICs), for example, are linked together in the solution to ensure that when a payment leaves the enterprise resource planning (ERP) system of the corporate "it guarantees that the corporate will have the minimum processing cost". Having scoured the various reference lists from around the world – including national clearing codes – and cross-referencing the results for accuracy, SWIFT is enabling corporates to upload the data to their ERP systems. Currently, coverage extends to SAP systems, but other interfaces (Oracle, Microsoft, etc) will follow.

Contrary to the belief that SWIFT requires users to have access to the SWIFT infrastructure, the modernisation of the society sees it delivering new solutions as channel-independent offerings. SWIFTRef, for example, will typically see the corporate become a client of SWIFT, just as it might buy market data from Bloomberg or Reuters. Of course, banks are not cut out of the loop and they can buy a global licence from SWIFT enabling them to pass the data to their own corporate clients via web portal as an added-value feature motivated by "transaction quality".

## Security: 3SKey and eBAM

Another motivation is defeating the cyber-threat. To this end, SWIFT's 3SKey (a purely commercial product) and electronic bank account management (eBAM) propositions – again, both independent of the SWIFT channel – have

been aligned to offer technical standards "to organise personal security services", so security connected directly to the individual, not the corporate or institution. 3SKey's primary function is in validating payments instructions: confirming the level of individual access, how much can be signed-off and so on. A secondary use relates to administration purposes and this is where SWIFT's re-structure has purposefully brought its eBAM offering into the same corporate services pillar as 3SKey.

The eBAM solution is intended to remove paper-based bank mandate management. 3SKey is a natural bedfellow in that electronic mandates can be digitally signed and the bank can validate the request. Both solutions can also be used to manage workflows within the corporate to ensure mandates are managed internally.

Plans for an eBAM and 3SKey central utility, where SWIFT would provide a multi-bank portal through which corporates could liaise with their banks, have been suspended indefinitely, says Casterman. The idea did not get as far as a practical offering. "We haven't been able to attract sufficient interest from banks so we have put this idea on hold for the foreseeable future," he explains. "We need to work at the pace of the market and in that market we couldn't develop a business case."

3SKey has to date only been adopted by French corporates, although it has been implemented around the world by these companies. BBVA, for example, announced last year that it had implemented 3SKey in six Latin American countries as well as Spain, Portugal, UK, France and Belgium, for its client, Airbus. "We now have banks in 50 countries getting ready or having adopted 3SKey," says Casterman.

## TSU and BPO

The fourth pillar of the new SWIFT structure brings in what Casterman refers to as "certainty and efficiency in the supply chain". SWIFT's Trade Service Utility (TSU) was launched in 2007 as a matching system for trade documents (letters of credit (LCs) or open account) so banks could provide funding at various stages throughout the progress of the physical supply chain (from order to payment). As part of the TSU bank-to-bank offering, in 2009 the Bank Payment Obligation (BPO) was introduced. This is an irrevocable obligation by a buyer's bank to pay a specified amount to a seller's bank upon completion of an agreed deal.

Until recently, BPO rules had been limited to banks acting on behalf of corporates. These rules have now been re-written to meet the standards of the International Chamber of

*BP Chemicals was one of the first corporates to use the BPO, adopting it in Q1 2012 and working with its Oman-based client, Octal and banking partner, Standard Chartered.*

As one of the corporate representatives on the BPO workgroup, David Vermynen, Global Credit Manager at BP Chemicals, has been involved with its progress for some 18 months. This has given him an up close and personal view of what it is capable of. "When I started to analyse what a BPO was and what the TSU was doing in the context of a BPO, I started to realise that there were a number of benefits for the way we do business at BP Chemicals."

The fact that it is electronic marks a "giant step" away from traditional paper-based transacting and in practical terms means messaging is almost instantaneous. Indeed, once it has been established and there has been a successful matching of a baseline in a data set by SWIFT, then the BPO becomes operational. This means it can be established a lot later in the process than paper-documentation.

An LC, for example, cannot be established after shipment, at least in the way BP Chemicals is working, as it tries to avoid letters of indemnity because they reduce the depth and level of security. Firms buying from BP Chemicals on LC are required to produce documentation five to seven days before the ship sails, at which point the use of credit has already been established and the importer is already paying for it. The BPO, however, can be easily delayed until the moment the bill of lading is secured from the freight forwarder, giving an instant five- to seven-day advantage. It is even possible to establish the BPO the moment the goods are discharged at the port of arrival, says Vermynen. In this case, the BPO becomes more like a documents-against-payment arrangement, in which the exporter instructs the presenting bank to hand over shipping and title documents to the importer only when the importer pays in full.

Although it has very experienced staff dealing with LCs on a daily basis, there are other efficiency benefits for BP Chemicals that can be derived from the BPO. "All that transacting, manual handling and pushing around of documents will be reduced significantly, taking the sting out of selling in a LC-based secured way," notes Vermynen. "What often creates pressure is being able to present documents on time. Once you have the BPO, the documentation you need to produce is not part of the critical path to obtain secured payment anymore, relating only to certifications for the shipment, concerning its origin or quality, for example, rather than being payment-related."

BP Chemicals' only experience with the BPO to date is with its customer, Oman-based PET manufacturer, Octal, via Standard Chartered. "Not all banks are at the same level as Standard Chartered, which has been a significant hurdle to doing more transactions," says Vermynen. "Another hurdle is that not many corporates understand what the BPO could mean for how they operate." There is, he notes, a lack of knowledge and a degree of "uneasiness" about the newness of the BPO. Even some product managers and sales managers in banks "don't yet really know whether to place it as an open account or LC product".

The arrival in April 2013 of the ICC's Unified Rules for BPO will be the "absolute confirmation that the BPO is a serious product", states Vermynen. It will certainly replace some LCs, but he feels it has the potential "to do so much more". Even if it is used simply as a tool to manage the timing of payments, he feels it "opens up as a conduit for all kinds of working capital optimisation". For now though, he comments that "we're happy with it and it does what it should do".

Commerce (ICC) and are set to be approved in April, giving it the same legal weight as a traditional LC.

ICC had offered the similar electronic Uniform Customs and Practice (eUCP) for documentary credits, which was an attempt at de-materialising documents by scanning them, but this was never used. BPO is a fully-fledged electronic document capable of fitting into an automated environment.

The ICC BPO moves SWIFT firmly into the corporate-to-corporate space, adding another option next to the LC, the demand guarantee, credit insurance and so on. Casterman, who sits on the executive committee of the ICC Banking Commission, co-chairing the BPO project, says LCs payments terms are linked to UCP 600 rules that govern the way banks exchange documents and data when executing LC requests from corporates. "The BPO is the same; it is a payment term implemented under the Unified Rules for Bank Payment Obligation (URBPO) for banks intermediating those transactions."

ICC is the legal weight behind SWIFT's messaging and matching technology for the BPO, although once again, corporate use of the ICC BPO does not require access to the SWIFT channel as it is brought to them via their banks (they will get a copy of the MT700, SWIFT's message format for the LC) who will charge similar risk fees for its use.

## Future plans

There are no additional products under development by SWIFT for the corporate community. "We are contemplating ideas such as how to extend 3SKey to mobile devices but there is no product development for the time being on the SWIFT side," Casterman confirms. Although banks still play the major role in facilitating the SWIFT-for-corporates relationship, the task of SWIFT now is seen by him as one of "de-mystifying" and demonstrating the inter-connectivity of its newly aligned and integrated portfolio of corporate solutions.

To this end, SWIFT is set to release in 2Q13 a new set of certifications for consultants on the supply chain side.

There is willingness for most SWIFT participants to have “implementations that are as light as possible”, comments Casterman. This understanding comes direct from corporate feedback and has driven the emergence of Alliance Lite 2, monthly fees and the service bureau movement. “They don’t want to become technical experts in SWIFT connectivity; they just want something that allows them to access it without the need for a team of engineers to understand how it works.”

SWIFT’s aim is to become a multi-business connectivity service for trade finance. “In the course of this year we will

see the trade vendors extend their applications from cash to trade and the data elements and transactional flows will be much more inter-connected,” comments Casterman. At least one multi-bank payments vendor will announce the extension of its application into the supply-chain finance realm, specifically the BPO, allowing a single software application for cash and trade.

SWIFT has been angling for corporate inclusion for a long time. It is now taking steps to offer a set of products that it feels will meet the needs of treasurers without tying them into a long, complex and expensive relationship that clearly few of them want. Perhaps 2013 is the year that SWIFT for corporates finally comes of age. ■

## Bank talk

*A brace of global institutions talk about their relationship with SWIFT.*

### Société Générale

Société Générale (SocGen) has had a long and productive relationship with SWIFT, says Alain Grugé, Head of Payments and Cash Management for the bank’s Global Transaction Banking unit. Although cash management is one of the primary uses of SWIFT by SocGen’s clients, Grugé explains that the bank also works with it on trade services, securities and card payments. “It is an increasingly global relationship and this is because SWIFT has been able to quite quickly move from its highly specific bank knowledge to include the accommodation of corporate needs.”

SocGen is part of SWIFT’s Corporate Advisory Group (CAG): the only French bank representative.

Grugé says, from a cash management perspective, that SWIFT provides very practical action with a “good adaptation of its products to the needs of corporates”. He cites the move to make the 3SKey digital signing tool available to a wider audience, and the ongoing workshops for the development of eBAM as examples of this consideration for the end-user.

Regarding eBAM, Grugé believes that the need for it is clearly evident and that many large corporates are anticipating its deployment. But SocGen is cautiously allowing its own clients to discover it at their own pace because, as Grugé notes, often they do not at first glance see the level of internal re-organisation that it can generate. So, whilst he feels eBAM is an important tool, he says “let’s take one step at a time”.

SocGen has never felt it is left to its own devices with SWIFT’s products. “We have constant dialogue with them,” states Lajeunesse. The bank has even established a working group on trade in France. Dialogue is similarly open on the cash management side, says Grugé.

SocGen readily undertakes development work with SWIFT and is currently looking to establish a pilot programme for a new 3SKey webstore. This, explains Grugé, will enable corporates to order the product as a standalone offering on the bank’s website, with direct provision by SWIFT. The end of 4Q13 should see this project in action, he says, noting too that the SWIFTRef solution is to be offered by SWIFT to the corporate community with the support of SocGen, but at a later date.

### Bank of America Merrill Lynch

“SWIFT has really improved in regards to getting feedback from its member banks,” says Tom Durkin, Managing Director, Global Head of Integrated Channels at Bank of America Merrill Lynch (BofA Merrill). A bank such as this has a number of significant corporate clients but it needs to gather viewpoints from all corporate clients and convey them to SWIFT. In “opening up the road-map discussions”, he feels SWIFT is in a position where it now reaches out to the banks to ask for feedback.

SWIFT is naturally a sponsor of a number of key standards forums and BofA Merrill actively participates in these, presenting on different topics and leading workgroups. Durkin feels this is a good way of getting more “community-based” involvement. The SWIFT space is not just about banks and corporates; there are also technology-providers that have a vested interest; the standards forums provide an “excellent avenue for utilising better feedback” for SWIFT.

Amongst the corporate community, the early adopters – typically large MNCs such as GE and Microsoft – have maintained their push for standards. But amongst the “commercial market” membership, catering to a wider cross-section of businesses, Durkin notes greater interest in “ISO 20022, XML and harmonising their bank interfaces”. For smaller businesses, he sees SWIFT’s commitment come to life in the form of its Alliance Lite2 lower-cost cloud-based model. He also views the SWIFTRef data offering as further demonstration that SWIFT is responding to corporate needs.

The closer integration of cash management and trade services, under the guidance of Casterman is a positive move, Durkin believes. The conversation between cash and trade “intersects at multiple points now” and with the desire to draw out certain “product synergies”, this connection has driven the way BofA Merrill has structured its GTS group, incorporating trade within its channel product offering.



# THE BANK INTERVIEW

*What are the key trade issues for the coming year – and more importantly, how will they be managed? Global and regional Heads of Trade from Bank of America Merrill Lynch engage with the topics that matter, providing insight for corporate treasurers the world over.*

## General outlook for 2013

**There is still much financial uncertainty in the world. How has this affected each region's trade flow and its place in the global trade arena?**

**Dennis Dubois – LatAm:** There has been a lot of noise about the overheating of the markets in Latin America but we need to be cautious as it's difficult to define because of the vast disparity between Latin American countries. In the case of Brazil, was it starting to overheat? Absolutely, but the government took steps to cool it down. However, with massive infrastructure projects being built for the World Cup and for the Olympics, as well as for badly needed infrastructure development, coupled with easier credit, the risk of overheating is real and needs to be carefully managed. Mexico has been 'rediscovered' by a lot of US companies which are looking to make new or expanded investments there, so it too could overheat. The same could be said of Colombia, and even Peru, to a lesser extent.

**Martin Knott – EMEA:** Our outlook on trade in EMEA remains positive, primarily predicated on forecasts from the WTO and projections that global trade will grow by 4.5% this year relative to global GDP growth of around 2.4%. The well-documented MENA-Asia flow growth continues to be significant.

**Maureen Sullivan – North America:** We haven't seen any slowdown in intraregional activity. From a US perspective, the projections appear to show a GDP-stable growth environment of around 1.6% for 2013. It's not overly robust, but it indicates stability. Our view is that because there will be increased spending and investment out of this region, it will have an impact in other economic regions. The brightest spot in the US economic landscape is with the export sector, which is poised for continued growth, with more robust trade lines between North America and Asia, and North America and Latin America.

**Kuresh Sarjan – Asia:** Asia tends to be the global hub of trade and there's a lot happening here, both inter- and intraregionally. It is a robust region for trade finance for the banks, as companies continue to relocate here, particularly in Singapore and Hong Kong and more generally in Asia Pacific. We operate with a direct presence in 12 countries across the region – and in others, such as Vietnam and Bangladesh, with preferred correspondent banks. In almost all we continue to see healthy activity.

**Do you see more investment by corporates outside of their own home regions?**

**Kuresh Sarjan – Asia:** Japanese companies have, for a long time, been at the forefront of global operation, but also now South Korean, Chinese and Indian companies have a much

**Bank of America  
Merrill Lynch**

**Bruce Proctor**  
Global Trade Head



**Kuresh Sarjan**  
Trade Head of Asia



**Martin Knott**  
Trade Head of EMEA



**Dennis Dubois**  
Trade Head of Latin America



**Maureen Sullivan**  
Trade Head of North America



bigger footprint globally. In fact, the base of Asian inter-regional investment has accelerated, particularly out of China and India.

**Maureen Sullivan – North America:** Historically we've seen our large corporate clients well-represented with international investments, but we anticipate that there will be broader investments by our mid-sized corporate clients over the next few years, in alignment with their heightened interest in expansion as a catalyst for corporate growth.

**Dennis Dubois – LatAm:** We are seeing a lot of mid-sized clients entering markets they might not have considered previously. Mexico has always been of interest as a long-standing US trade partner. Given its proximity to both the US and LatAm markets, some companies are discussing either shifting or expanding manufacturing in Mexico to replace or add to what they are currently doing in Asia and evaluating how that drives supply chain/logistical efficiencies. Brazil clearly remains the principal magnet in the region, but we also have numerous large and mid-sized clients interested in selective investments in Colombia and Peru.

**Martin Knott – EMEA:** It is important to understand the drivers behind this investment where it happens. For example, it may be to widen a client base or to find new or contingency suppliers. From the supply-chain perspective, we continue to see demand from Asia — China in particular — albeit activity is wide and varied. Whilst there has not been a significant change in the level of investment specifically from a trade perspective, the rationale and drivers have changed over time.

## Trends in products and services

**Looking at global versus regional capabilities, are there truly any trade products or services which can be used in any country?**

**Bruce Proctor – Global Trade Head:** When we approach product development or roll-out we try, wherever possible, to have a standardised approach that can be adapted to fit specific market requirements. We have to take a broad view of how products fit in the market and how we can use them effectively so we are not, for example, taking a US product and force-fitting it into South East Asia. As we take it to the regions we ask what we need to do to make sure we are competitive and compliant with all local requirements – but we also give our clients something of a global experience.

**Kuresh Sarjan – Asia:** This is a regulated market environment and regulations continue to change, depending on each country's priorities and political imperatives and their own capital and external debt and balance of payment positions. In China, for example, there was a material change last year in the way banks were allowed to account for their short-term trade borrowings, e.g., having to treat the trade advances they received for their own existing trade exposure as 'on balance sheet' items. As a result, we've had to restructure a number of our products which are applicable in the FI space in China.

**Maureen Sullivan – North America:** Generally, trade products allow clients to do business in different countries by normalising the nuances of different regulations, language, customs, and so on, and this is the sweet spot of trade finance. We help our clients interact with their counterparties and reduce risk in the most cost-effective fashion.

**Dennis Dubois – LatAm:** Although most trade products are fairly homogenous, where variations are seen, they tend to be less about the product itself than how it can be used. As an example, in some countries withholding taxes can be an issue depending on how transactions are structured, so deal structure is likely to be more important than the product itself.

**Martin Knott – EMEA:** It is always important to look at the client's in-country requirements for a deal structure. These requirements may be different for the operating company of, for example, a US-parented company, compared to those of a client indigenous to that country. Acceptability from a local regulatory perspective, and an appropriate legal framework, will always be a leading consideration.

**Will we see a move to multi-banking, where banks use the same neutral platform, in the trade business as we have in cash management?**

**Martin Knott – EMEA:** From a technology perspective, we have seen more multi-bank deal structures, particularly in the supply-chain finance space. As clients have looked to expand their programmes either by value or geography, the need to bring in multiple banking partners has increased.

**Maureen Sullivan – North America:** There is already a nascent version of a multi-banking platform that exists for some of our large corporate clients. This was established as they migrated to host-to-host file formats. There is opportunity for further improvement though, to eliminate a lot of the separate integration effort, but the challenge is the cost-benefit of deploying and maintaining a neutral platform from which all participants can benefit. It continues to evolve, so we do see multi-banking, but not necessarily across all trade finance products.

**Dennis Dubois – LatAm:** What applies to North America also applies to Latin America where, among the largest companies, cost-benefit is always evaluated. Yes, they would ideally like to be on one platform rather than multiple bank platforms, but a lot of LatAm corporates are still very closely tied to one or two banks in-country. Those banks may have less sophisticated platforms, but they will always be part of the relationship, so it's a two-track development dependent on client size and sophistication.

**How are new solutions and technologies such as SWIFT's Bank Payment Obligation (BPO) and International Chamber of Commerce (ICC) Uniform Customs and Practice for Electronic Presentment (eUCP) received in the regions?**

**Kuresh Sarjan – Asia:** There is a healthy interest in new solutions with a number of players across the region, particularly in China and India, adopting SWIFT tools in the trade space. When guidelines for the BPO are published by SWIFT and the ICC Banking Commission, it will drive further impetus in this area.

**Dennis Dubois – LatAm:** If there is a new solution that we can deliver, and local traditional banking partners cannot, when benefits are clear to the corporates, they will obviously work with the banks that can deliver. But when it comes to the traditional product suite, long-standing relationships are still an important component of decision making, though less so in top-tier clients and markets.



**Bruce Proctor – Global Trade Head:** The ability to be able to move more quickly onto newer technologies will be a driver of a lot of business. Generally, businesses in developing countries are faster at moving to newer technologies because they don't have the legacy systems in place to impede progress. But, increasingly, all trade clients are technology-dependent and that is why we are investing substantial sums into our client-facing and operating platforms and processing capabilities. The fact that we have made all our products available paper-free is an indication of where this industry is going.

**Maureen Sullivan – North America:** Our corporate clients are always looking for ways to streamline the document-intensive nature of trade finance. They are looking for a less-costly solution, and one that will give them greater visibility. But there is a hesitancy to go down one path unless there is confidence that it will be the standard. There is a wait-and-see approach around which protocol gains the greatest number of users.

#### **Another wait-and-see for 2013 is how far renminbi (RMB) will progress as an alternative currency.**

**Kuresh Sarjan – Asia:** The RMB continues to rise in its acceptance as a trade settlement currency in the region. I think the size of what it will constitute, as a percentage of overall global trade, investment and payment flows, is still anybody's guess. There are projections of between 10% and 30% by 2015. How soon will it become a substitute or alternative to USD, again, is anybody's guess. But the numbers are sizeable and there has been much progress over the last few years.

**Bruce Proctor – Global Trade Head:** One of the big questions is whether it will become freely convertible on a broad scale. If there is an aspiration to make it a reserve or alternative currency for a substantial amount of trade financing, the ability to freely obtain it through commercial foreign exchange transactions, or to be able to provide longer-term financing in RMB outside of China, are issues that need to be addressed. We will certainly see more Asia-related activity in RMB.

## **Key players**

### **Global mega-banks have long-dominated the global trade market, but a number of large regionals have become formidable competitors. How should global banks respond?**

**Dennis Dubois – LatAm:** It's really a question of market segmentation and focus. In some markets, such as Brazil, Chile and Mexico, there are large indigenous banks who offer local products needed by all local companies. International banks offer global solutions to large local clients but most have little interest in offering purely local solutions. There is a space where both can offer complimentary solutions and partnering, either from a balance-sheet perspective or through access to local infrastructure, which can make a lot of sense.

**Kuresh Sarjan – Asia:** Regionals in Australia, Japan and in South East Asia, for example, are moving forward rapidly. We collaborate with them on developing solutions that benefit common clients, and we work with them as clients, but this is an important sector to watch. The overall trade finance product suite continues to evolve and our regional peers have

some very good solutions. It is a large market, but at the same time it is highly competitive.

**Martin Knott – EMEA:** In the region there are domestic, regional and global mega-banks. It is less common that all three will be going after the same client, so in the trade space there continues to be room for a number of players. Additionally, we see more opportunities for banks to work in partnership to meet client requirements.

**Maureen Sullivan – North America:** Global banks that have the footprint can provide sophisticated financing and structuring solutions and offer an on-the-ground presence in support of multinationals. However, regional banks continue to play a role, working through the mega-banks, in the delivery of trade solutions where regional banks don't have the on-the-ground presence. It can be a synergistic relationship and does not have to be either/or.

## **Risk management, credit and pricing**

### **The financial crisis has tightened credit. What trends are you seeing in the regions, especially around risk management?**

**Kuresh Sarjan – Asia:** In terms of specific measures, there are a number of syndicated structures in the region for trade. We are one of the largest trade risk distribution desks in Asia Pacific. This enables us to give some reciprocity to some of our preferred trade correspondent banks, in Europe for example, that may not have as large a footprint as us in Asia, but at the same time allowing us to share the risk.

**Martin Knott – EMEA:** In general terms, I think one of the key elements of risk is perception. Using technology to assess risk is one tool, but it is no substitution to living and breathing the market in which you are operating. In trade we continue to see increased activity in the risk distribution, securitisation and risk insurance space as effective tools for the trade business.

**Maureen Sullivan – North America:** Key for us is managing reputational risk and being sure we are in compliance with all regulatory requirements and guidelines. We deploy a variety of risk-mitigation activities to help us manage our trade finance solution set, making sure standalone products can be accretive to the overall banking relationship we have with our corporate clients.

**Bruce Proctor – Global Trade Head:** As well as reputational risk, risk understanding from a credit point of view is critical as it supports our client selection process. Our regional offices spend a lot of time working with our legal and compliance teams and with our operational groups, to ensure that we are really taking a broad view and doing the right deals with the right clients and in the right manner.

As part of a successful relationship, something that is incumbent upon us as a global player, is to be viewed by our clients as a good source of knowledge. Increasingly, they are looking for insight, advice and information on their markets. We operate on the ground in many countries and have a lot of exposure to events in the economic, political and social spheres and can help them. I think that is truly a differentiation point. ■

# Creating and issuing a bank RFP

*Replacing or establishing a major treasury relationship is not something to be taken lightly. In this second part of our look at the request for proposal (RFP) process we discuss the finer points of selecting a banking partner.*

The request for proposal (RFP) process is all about starting a formal dialogue with a pool of potential banking partners that you feel may be best placed to respond to your needs. It takes time and consumes resources, but it can provide far better results than an unstructured approach. If the need to at least review your banking partners has been established, the process that follows must lay bare the exact set of priorities that are driving change. From the outset it must be decided which priorities are fixed and which have a degree of flexibility. In short, you must know precisely why you are doing it.

Often an RFP results in a different banking structure, processes and technology. So it is also important to secure senior-level buy-in for the change, bringing on board the different functions and entities that will be affected up and downstream, explaining why it is necessary and what the expected outcome is.

The process of bank selection may be led in-house or, if there is insufficient experience of the selection process or the project is complex, an external consultant may be called in. If opting for an internal team, it is essential to afford them sufficient time to discharge their duties. It may be worth dedicating an individual to manage the process for the duration. Doing the day job at the same time may induce an element of nervous tension that may not yield the best results.

However, the existence of job titles such as treasury project or programme manager within large corporates indicates that this is a role dedicated to change and a bank RFP would slot perfectly into this portfolio. If such an individual is not available, the best compromise is to take blocks of time out of a more traditional role. This means, however, that there should not be any one individual on the team who cannot afford to be out of the office – cover may need to be arranged for critical roles (interim treasury management has gained in popularity in recent years).

In a multinational corporation (MNC) there are typically three sets of stakeholders with overlapping requirements to consider, which makes collaboration key:

1. Treasury has a set of needs focused around bank relationship management, liquidity and, to a degree, technology.
2. The business functions have requirements around getting the money in and paying out.

3. Shared services (if deployed), as an internal service provider, will straddle both.

The needs of the IT function, as the fourth estate, should also be considered as this may be seeking to overlay a structure on all other stakeholders.

In essence, the first phase should define exactly what the business is trying to achieve, what its range of options are and how the business decides between these options. A bank selection has potential to be complex but this stage should not drag on for months.

It may take time to collate all the required information, service definitions and data, but once gathered this discovery stage should be afforded a day or two of intense discussion, involving relevant representatives from all stake-holding functions to enable agreement upon the intended direction.

Co-ordination of the project tends to fall to treasury rather than procurement or any other function simply because treasury has the financial services background and the eventual task of managing bank relationships.

## Starting the selection

Once a steering document has been published, only then should the business start thinking about which financial institutions might be able to help. The golden rule is that the bank or banks chosen have to be able to meet all genuine business requirements. This is why it is so important to have a requirements document with buy-in from all stakeholders and have all the relevant information to hand; no bank should be expected to figure it out itself.

Where a company operates a decentralised model, the selection team can struggle to get all business units engaged. But if business requirements suddenly appear when it's too late to make changes to them, then the team will have a battle on its hands. To try to counter this, it is possible to explain the intention to all although it may not be possible to talk to each and every business unit. The project team can then ask for volunteers to be involved in the review – on the understanding that if an individual business is not represented, its place at the table will be taken by a representative from a similar business that has volunteered, and that its view will only be taken at the decision-making stage on the basis that it has shown commitment from the outset.



## Straight to RFP?

Once the big picture has been established and the necessary detail has been added, a long list of institutions that are apparently capable of doing what is required can be generated. It may be desirable to go straight to RFP but often it is advisable to reduce that long list. The reduction process can be formalised using a request for information (RFI) in which the fundamentals are laid out and sent to banks, which then respond with high level information confirming or otherwise their suitability.

It is also possible to approach, in an informal manner, a set of institutions that have a fairly close match to your requirements. Here you may state that there is a need to go out to tender, that you have a number of potential banking suitors, and then, putting everything up front, ask directly whether each has the capacity to deliver on your high level requirements. It is preferable to have a bank self-disqualify than find out later that it cannot meet the criteria. Some may still be tempted to provide inaccurate answers but their stock will decline as a result when their inadequacies are revealed. It may even prove to be a major issue at a later stage of assessment if the offending bank has taken the place of a genuine contender and the selection has been reduced to a final short list.

If you are seeking new ideas, or if you feel there are services or products you might not be aware of, the early stages are where it must be done. You should not limit the banks' ability to bring good ideas to the table but the RFP stage is where you will be looking for structured evidence of their capacity to deliver; the process should not be clouded by giving the banks carte blanche to throw everything at you, as it will make assessment very difficult.

The number of banks needed on the short list is open to debate. Obviously more candidates provide greater opportunity to find the most appropriate partner; but the bigger the list, the more difficult it is to make a comparison, which may detract from the attention required to make the best decision.

## Drafting the document

In terms of ground rules for drafting an RFP, the simple advice is to be frank and open but omit irrelevant information. Fear of divulging sensitive information should not prevent the revelation of key points; a non-disclosure agreement (NDA) can be put in place if necessary. Explanations of company structure and other background detail should be included only if it helps the banks understand what is needed. The requirements definition itself must be expressed in a clear and concise manner, with a logical progression between points.

Whilst pre-formatted RFPs exist and provide excellent checklists for basic capabilities, every project is different and has its own objectives and nuances that cannot be conveyed in a standard form. But it is nonetheless essential to discover how each bank proposes to handle these, going beyond overly broad objective statements which will elicit from the banks either very little or something approaching a 'kitchen-sink' response.

Whilst there will be a number of yes/no responses designed to clarify basic points, the key elements of your own unique needs must be translated into a clear and open document. This must ask the right questions to be able to draw out critical detail from the banks' responses. The RFP offers banks the opportunity to express the depth of their solutions

and is a way of seeing if they can do what you want them to do. Their responses also demonstrate how well they understand your needs, how far they are prepared to go to meet those needs and how they propose to offer follow-up support on a day-to-day basis. It is also vital that they demonstrate their commitment to future deliveries of their products, services and technology because these will have to match your own plans to progress if an early re-selection process is to be avoided.

A typical banking RFP may extend anywhere between 15 to 40 pages. The responses will be at a minimum 40 pages and maybe as many as 200. Give the banks time to respond, as multiple specialists may need to consider their respective responses. A window of opportunity should be opened where dialogue can take place, but remain transparent about the process: whatever responses you give should be given to all participants, thus maintaining a level playing field. To this end, ensure the rules of engagement are set in advance so that the bank's project co-ordinator (who will handle your RFP) knows who they can and can't talk to within your company. It is advisable to log all communication.

## Analysis of returns

When you do get the responses, read them all – another good reason not to send it to too many banks. When making a comparison you are basically assessing the adequacy of service provision offered by each bank for each key area. Because many corporates, especially the largest MNCs, spread out across the world to such an extent, even the top ten biggest banks could not hope to fully support that reach. Given that there may not be a 100% fit, usually there is a trade-off which may involve taking the best aspects from two banks. The decision regarding acceptable compromises is one for the stakeholders, but this can be aided by the use of weightings – giving each response a numerical value according to its relative importance to avoid the outcome being unnecessarily swayed by something that has low value.

At this stage most project teams will want to meet the banks' teams. The human element should not be underestimated, especially as treasurers will often have to work closely with these people. This can be the point where you ask for evidence of their proposal claims (quantifying cost savings for example).

These meetings will typically be between two to three hours and there needs to be a team-discussion afterwards. Slotting one in the morning and one in the afternoon may not be a good idea if that discussion is to be of any value. If you take the time and trouble to call them in, give them the space to expand their response, and do them the courtesy of allowing a full discussion of what they have to say.

## A last look before deciding

Having seen the responses and met the shortlisted banks you should now be in a position to create an order of preference. But there are other elements that also need to be tackled. As an extension of meeting the presentation teams, it is also worth meeting their customer services representatives. If there is new technology coming in that you are not familiar with, then you should arrange for a demo, structured around your needs. Contacting references is also advisable. The expectation that these will always be unreservedly positive is not too far from the truth; however, diligent questioning will

often throw up some interesting points, some of which may be to your benefit. At the very least such a meeting can give some assurance that the bank is capable of doing good work.

The decision is now yours but if an RFP has been executed well it will be one made with an appropriate level of due diligence.

RFP responses may even be retained as the basis upon which the implementation of the bank solution is measured and monitored. But beyond providing the right banking solution for today, a well-prepared RFP should also go a long way towards providing the right banking partner, which is hopefully one that can be retained for many years to come. ■

### Checklist of RFP processes for bank selection

- ☐ Before starting on a major bank selection, appoint a strong project manager. Consider a third party for the role.
- ☐ If an internal appointment, ensure they can remain objective. Consider having them dedicate blocks of time to the role for the duration. Arrange for cover for them, if needed.
- ☐ Think carefully about which functions and individual within the company should be involved in the consultation process. Document any agreements with them in advance.
- ☐ Ensure you clearly understand and have documented what your main requirements are, why you are doing this and what you expect to achieve.
- ☐ Refer to this document often.
- ☐ Be flexible regarding your plans – it may be that more than one bank is required to cover all of your needs.
- ☐ Don't change anything in the selection plan without managing and documenting it first.
- ☐ Always establish a requirements definition.
- ☐ Undertake preliminary research (using Treasury Today resources, conferences, bank websites, discussion with peer-group and an informal discussion with banks).
- ☐ Consider issuing an RFI.
- ☐ When building an RFP always ask if it conveys precisely and clearly what it is you require.
- ☐ Ensure questions are clear, understandable and have been tested and proven as such.
- ☐ Do not ask unnecessary or unreasonable questions.
- ☐ Some questions may be approached from different angles to test consistency of response.
- ☐ Beware of simply repeating questions (most likely if the RFP is the product of multiple departments). Proper co-ordination is required to maintain professionalism at all times.
- ☐ Ask open questions where detail is necessary and closed questions where a simple yes or no is sufficient. Remember that open questions are more difficult to compare.
- ☐ Lay out the RFP clearly, in logical order and with sufficient room for a full response.
- ☐ Complex requirements should be broken down into logical, manageable sections.
- ☐ It is in your interest to provide sufficient information to enable the bank to give the fullest answer possible.
- ☐ Do not over-burden the bank with unnecessary background information.
- ☐ Weight each question according to your own values.
- ☐ Agree upon weightings before sending the RFP to banks.
- ☐ Clear your mind of any bias for or against specific banks.
- ☐ Don't send it to too many banks: it makes analysis difficult.
- ☐ Read all responses carefully.
- ☐ Look for added-value in bank responses eg raising new but useful points.
- ☐ Learn to distinguish between fact and sales talk.
- ☐ Resist the temptation to adjust weightings to get the answer you want.
- ☐ Meet the banks, meet their customer services teams and take up any references.

Part one of this article can be found at <http://treasurytoday.com/2013/03/creating-and-issuing-an-rfp>



## INSIGHT AND ANALYSIS

### Shifting global dynamics

The world is seeing a dramatic shift from West to East in terms of dynamic economic growth, which some have coined the 'great rotation'. With China opening up further to corporates and levels of foreign direct investment (FDI) in the country growing, will the US Century transform into the Chinese Century?

## RISK MANAGEMENT

### Managing liquidity risk

Although everyone always talks about cash management, it has become more important because liquidity is much scarcer today than it has been in the past. Treasurers are striving to ensure their companies have the liquidity that they need to run the business. What are some examples of best practice in how to manage liquidity risk? What questions should treasurers be asking?

## TREASURY PRACTICE

### Tackling fraud

The extensiveness of fraudulent activity and the resourcefulness and imagination of the perpetrators – internal and external – makes it challenging for corporations to combat fraud. What are the steps that corporations can and should take to mitigate their fraud risks and also reduce the impact of such incidents to their organisations?

**We always speak to a number of industry figures for background research on our articles. Among them this month:**

**Mark Adamson**, Owner, Mark JD Adamson Ltd; **Gurpreet Banwait**, Product Manager, FINCAD; **André Casterman**, Head of Corporate and Supply Chain Markets, SWIFT; **Philippe Danjou**, Board Member, International Accounting Standards Board; **Tom Durkin**, Managing Director, Global Head of Integrated Channels, Bank of America Merrill Lynch; **Alain Grugé**, Head of Payments and Cash Management, Global Transaction Banking, Société Générale; **Sridhar Kanthadai**, Regional Head, Transaction Banking, North East Asia, Standard Chartered; **Anne-Sophie Lajeunesse**, Head of Sales for Trade Services, Société Générale Global Transaction Banking; **Ken Lillie**, Director, Lillie Associates; **Michael McGovern**, Group Treasurer, Irish Dairy Board; **Karlien Porre**, Treasury Advisory, Deloitte UK; **Bas Rebel**, Senior Director, Corporate Treasury Solutions, PricewaterhouseCoopers; **Diane S. Reyes**, Global Head of Payments and Cash Management, HSBC; **Adrian Rodgers**, Director, ARC Solutions; **Paul Stheeman**, Independent Treasury Consultant; **Mark Vaessen**, Head of IFRS, KPMG Europe; **David Vermeylen**, Global Credit Manager, BP Chemicals; **Kelvin Walton**, Director, TreasuryWise; **Brian Welch**, Managing Director, UserCare Treasury Consultancy Limited.

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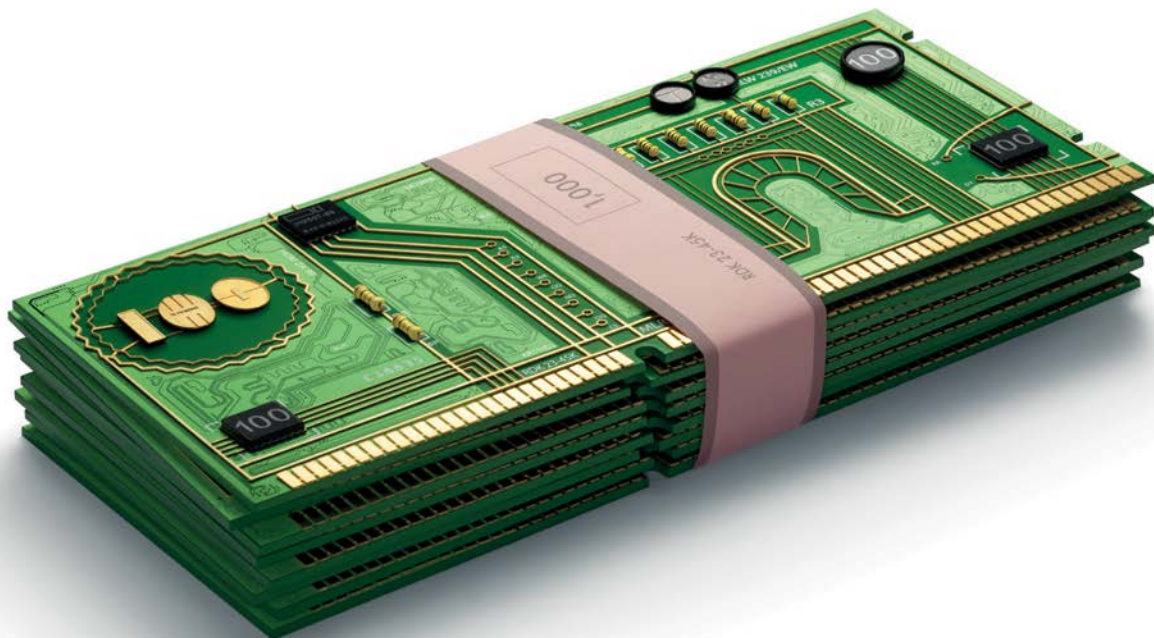


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