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May 2013

From West to East

The dynamism of Asian markets is a magnet for investment and expansion. Today the attraction is broadening beyond the region's heavyweights, China and India, to up-and-coming markets in South-East Asia.

Women in Treasury

Ellen Cornelissen

Director Treasury Europe
Aleris Switzerland GmbH

Bank Interview

Jim Fuell

Head of Global Liquidity, EMEA
J.P. Morgan Asset Management

Bank of America Merrill Lynch

The power of global connections

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The definitive industry benchmark

With nominations now closed, Treasury Today can announce that the 2013 Adam Smith Awards has once again attracted impressive entries from some of the world's most innovative treasuries.

The number and sheer quality of submissions surpassed all our expectations. We would like to take this opportunity to thank each and every one of you who participated this year.

More than 200 entries were received from 25 different countries and from a diverse world of industry sectors. This year's programme has attracted entries from some of the world's largest organisations, along with a strong representation from the mid-market enterprise (MME)/small and medium-sized enterprise (SME) universe. We are delighted to see such a range which realises our ambition that these Awards are open to all, irrespective of company size.

Over half the submissions were global entries, reinforcing the corporate treasurer's ever-increasing role and responsibilities. In terms of the benefits cited, process efficiencies, risks removed/mitigated, productivity gains and cost savings were the most popular boxes ticked, with some extremely impressive results.

Our judging panel now has the daunting task of first short-listing and then making their final decisions on the winning entries.

We look forward to celebrating your achievements during our Awards Lunch at a prestigious venue in the City of London on 20th June.

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Director Treasury Europe

Aleris

Ellen Cornelissen, Director Treasury Europe, Aleris, moved from linguistics to treasury early in her career and never looked back. Today she oversees European operations, but also supports the new treasury set-up in Zhenjiang, China. The migration to Single Euro Payments Area (SEPA) is the biggest challenge facing her this year.

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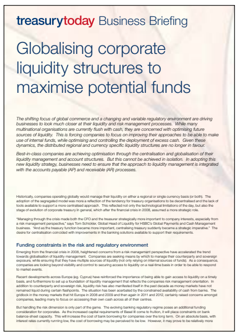

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This much I know

Ellen Cornelissen

Director Treasury Europe

Aleris

What is your career-defining moment?

There were two moments. The first was being able to move into finance without a finance background – I studied languages at university. The second was creating a cash management structure at Adtranz, an ABB and Daimler-Benz joint venture, which opened up my eyes to the world of treasury and is where my love for treasury was born.

Which women in business most inspire you and why?

My boss at Bombardier, Colleen Sidford, who I found inspiring because she is a professional, yet never lost sight of the fact that she is also a woman. She is an extremely knowledgeable treasury expert and I am eternally grateful for having learned so much from her.

What is the biggest challenge you are facing just now?

It is a combination of the ongoing Eurozone crisis, general market instability and currency fluctuations. Also, as we have built a new state of the art rolling mill in China, one of my main objectives is to set up a treasury function there. It is challenging but also very encouraging to be able to set up a new structure that supports our growth in a strategically important region for our company.

What couldn't you manage without?

My husband who is always there to lift my spirits when I am feeling low. After all these years, he still supports my commute between Germany and Switzerland.

What is your next major objective?

An imminent goal on my horizon is migrating to the Single Euro Payments Area (SEPA). I have set up a working group to cover all areas involved (legal, IT, accounting etc) but our treasury team leads this project for Aleris in Europe. In China, I am setting up a solid treasury function that can function autonomously within the global group and support our customers in China. Another main item there is to implement – with my US colleagues – a credit and collection structure. This is especially interesting as payment and collection structures differ much from Europe or the US.

In addition, a big item on my to-do list is increasing understanding of trends in our business in credit and collection. It has become increasingly important to ensure that the team is fully up to speed in adapting to changing market conditions.

What advice would you give to other women in treasury?

Go to conferences, network, make contacts and don't be shy in asking others for advice or a chance to brainstorm for fresh ideas. That is what I have done in the past and the vast majority of people have enthusiastically responded to me.

If there is one thing you could have done differently in your career path so far, what would that be?

Looking back, even though I enjoyed studying languages, I would have done something more in the financial space. It would have been easier to have more knowledge before I started.

"An imminent goal on my horizon is migrating to the Single Euro Payments Area (SEPA)."

ON THE WEB

To read all the interviews in this series go to **treasurytoday.com/women-in-treasury**

When asked what she would be if she wasn't Director of Treasury, Ellen Cornelissen quickly responds: "Unhappy?" She loves the work because of its diversity, which includes handling cash as well as liaising with banks, legal teams, suppliers, etc. "A long time ago I considered becoming a musician – so that is another love I have. I play the violin and viola. But if I really think about changing jobs today, I would probably return to my old job as an interpreter."

Interestingly, Cornelissen began her career as a linguist. She has a Masters degree in languages, but made the switch to finance in her early 30s, mainly because a Dutch bank in Germany was looking for someone who could speak three languages fluently. "They hired me with the comment that since I had gone to university, I was smart enough to learn the rest," she laughs. She decided to give the job a chance because she had always been interested in finance.

Cornelissen completed an internal trainee programme with the bank to get up to speed and also did a lot of external training herself. She had the opportunity to move into treasury when a client of the bank, who needed in-house help to deliver on a cash management project, hired Cornelissen after a six-month secondment. She observes that the trend today is to move from banking to treasury – despite much movement in both directions historically – because the latter is considered to be "much safer" than the former.

Looking back, Cornelissen thinks that, even though she enjoyed studying languages, she probably would have studied in the financial discipline because of the many weekends over the years that it has taken to complete her financial education. "It would have been handy to have had more knowledge before I started," she admits.

However, it is true that her language skills have proved to be a huge asset. "In my job at Aleris, it helps me tremendously. The company has a production site in Duffel, Belgium so I can speak Dutch with colleagues, but if I go to the production sites in Germany I can speak German. This is a huge advantage because communication is key. I have noticed quite often in my career that things don't go well if there is a communication problem, and that can also be from misunderstanding or misinterpreting items if the language is not your native tongue."

Today, Cornelissen is Director of Treasury Europe at Aleris, which is an aluminium producer with a proximate revenue of $2 billion in Europe. She also oversees the treasury function and supports the new set-up in Zhenjiang, China.

"From a daily perspective, it is a typical treasurer's job," she says. "I communicate with my banks and keep them happy. I have a small team to do the regular cash management items, such as the cash position and FX. We are responsible for the guarantee side, so ensuring that letters of credit (LCs) guarantees are issued on time and if necessary. Another part of the team is responsible for collections in Europe. Of course one of the main items remains cash forecasting."

In treasury, Cornelissen has two employees reporting in to her, whereas for collections she has 15 people across Europe that work locally. She has dedicated one of the treasury team to work on the Single Euro Payments Area (SEPA). "It is a slow process but we are getting there," she says.

She is also responsible for the liquidity in Europe, including inter-company financing, loan terms and bank agreements. "This is one job that I do myself because of the importance of liaising with the teams to make sure we have enough liquidity and are using it appropriately."

Operating in China presents specific challenges. "It is difficult to get money into the country due to regulations or get money out if you need to repay inter-company items. And capital injections can take days," she explains.

Although Aleris does not have an official mentoring programme, the finance team gets together to identify who needs mentoring and the best person to do the mentoring. Cornelissen believes that there is much to be learned from mentors, as well as having the support and help from others who have more experience in avoiding common pitfalls. "I personally think that many women could benefit from mentoring, because in my experience women are much more reluctant to promote themselves. Therefore, some coaching and support in how to present yourself and how to make your achievements known within the company could be a great benefit." ■

Ellen Cornelissen has been Director Treasury Europe of Aleris since 2009 and has held several positions within treasury at other multinationals including Adtranz, Bombardier abd Invista. In addition, she has a background in banking, having worked for ABN Amro and HSBC. Cornelissen has worked in the Netherlands, Germany, Belgium and Switzerland, and is currently based in Switzerland. She holds a Masters degree from Radboud University (Nijmegen, NL) and is a CertICM.

Aleris is a privately-held, global leader in aluminum rolled and extruded products, and recycling. Our company is based in Cleveland, Ohio, with approximately 7,200 employees in regional offices and more than 40 production facilities around the world.

The company is an industry leader with diversification across geographies, products and end-use industries, including aerospace, building and construction, defense, distribution, heat exchanger, industrial products, molding and tooling, packaging and transportation.

The female perspective

As part of our groundbreaking new Women in Treasury initiative, we are launching a major study of women working within the treasury profession. The objective of this annual study is to build up a picture of the profiles and careers of women at different levels across the treasury profession from junior positions to Group Treasurer/Financial Director/CFO positions. We believe that the findings may surprise us all.

Women in Treasury 2013 Study

Despite improvements, treasury and finance remain predominantly a man's world. Nowhere is this more apparent than at industry events, where women certainly do not make up half of the delegates and, more tellingly, where astonishingly few make it onto the speaker platforms. This gender bias is perpetuated as a result of individuals recruiting staff in their own image.

In order to change the status quo, it is important to understand the challenges that women may face when working in treasury. The first step in changing anything is to recognise openly and clearly that a problem exists. Once we have done this we need to assess how deep the problem is and what the potential causes of it may be. For this reason, Treasury Today is inviting female treasurers to participate in an annual study to help chart the profession's path to diversity.

A targeted study will help corporates examine how they build and maintain a best-in-class treasury function, believes Carole Berndt, Head of GTS for Europe and EMEA at Bank of America Merrill Lynch. "It also provides an opportunity to use the results as a tool to engage and to promote change. Insight gleaned from surveys can feed into employee development programmes and be applied to create best practice processes at a company."

In addition to gauging female treasurers' reaction to the hotly debated quota question, the survey will address a number of areas that are potential hurdles to successful careers for professional women across most industries, including:

- Work-life balance.
- Pay parity.
- Mentoring/networking.
- Career progression.

Work-life balance

There is no doubt that the prevalent long hours and 'always on' culture in treasury make it harder for women who are juggling childcare with careers. The societal norm dictates that a woman has greater responsibility for the household and children and it is hard to believe that there can be any mothers for whom this has never been an issue, although some may claim so. In fact, part of the whole problem around the work-life balance question for women may relate to their inability to openly declare that there is a problem, preferring to struggle on than to admit that things can be a challenge.

The Managing Director and new Head of Transaction Services EMEA at J.P. Morgan, Sue Dean, links this issue to a well-worn myth of 'having it all'. "I think we beat ourselves up unnecessarily, thanks in part to the old school 'having it all' myth, which suggests that a truly successful woman has a fantastic career, great relationships, perfect children, a sharp wardrobe and a tidy, stylish house. No one has it all, for it is all a balance – and you drive your own balance by the choices you make."

It is a growing trend that more and more companies are beginning to adopt flexible working hours. Berndt makes the point that cash management has become an increasingly global arena with companies expanding across borders and time zones. "Today, I would argue that you can be as effective in your role working remotely at 9pm as you are working from the office at 9am."

This, as we are all aware, has changed the way in which we work and granted a freedom and life flexibility that no previous working generation has enjoyed.

Pay parity

"The playing field is not yet equal for women, and women are evaluated differently than men. The fact is women have to negotiate things for themselves that their male colleagues take for granted," according to a University of Exeter (UE) report entitled 'Gender diversity in the financial services sector' (January 2013). The report cited a 2003 study of business students which found that 85% of men felt that it was up to them to make sure their company paid them what they were worth, whereas 83% of women assumed their worth would be determined by what their company paid them.

A Swiss-based female Treasurer raises an interrelated issue called the 'Tiara Syndrome', a term coined by Carol Frohlinger to explain the belief that by keeping your head down and delivering excellent work, people will notice – and eventually place a tiara on your head. She argues that women need to make a conscious effort to raise their profiles internally and externally, such as vocally participating in conferences, team meetings and networking events.

Mentoring/networking

Many women in the financial services sector cite a lack of role models and mentors in the industry as one of the barriers to their own career progression, according to the UE report. It is a fact that is becoming increasingly noted, that whilst men are great at supporting one another professionally, at all levels of their career, women have been quite woefully poor at this key networking and mentoring. This has resulted in a female workforce that, although incredibly capable, are bad at self-promoting and are something of an invisible power in companies. Key mentors throughout a career are vitally important and this mentor need not be of the same gender to oneself. Dean agrees that senior level sponsorship is key to success. "We all need people who understand our potential and will advocate for us. They can be male or female – it doesn't matter. Building your network and developing advocates in this way is critical."

Career progression

According to the UE report, a recent phenomenon is the opt-out revolution: women choosing to leave the workplace, often in their thirties or forties, when they are just beginning to achieve success. There are frequent comments that women simply are not driven by the same goals and motivations as men, but that is a simplistic answer to complex issues.

It is true that some companies think twice about hiring or promoting younger women because of the possibility that they will take a 'career break' to have a family. Companies are obviously unable to be frank about such choices and it is near impossible to prove, particularly for smaller companies, yet this has got to be something that comes into play because of the financial implications that it poses. How do we get around what appears to be quite a sticking point?

Differing experiences

Not all professional women face the same obstacles or have similar experiences. The most noticeable differences can be seen between regions. In addition, it will be interesting to see if there is a marked distinction in responses from women under the age of 40 (versus those over 40), which is indicative of the developing career potential of treasury. Ten years ago there wasn't a career path into the profession. Instead many entered into it by chance, maybe as an accountant or controller. However, today there is specific treasury training and many are making a conscious choice, it will be interesting to see if the results reflect this hypothesis.

The results of the Treasury Today Women in Treasury Study will be published in an editorial feature in the October edition of Treasury Today. The results will be presented during a webinar and will be available on the Women in Treasury section of the website. To participate in the study, please visit:

treasurytoday.com/women-in-treasury

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Counterparty credit risk

What is the most effective way for corporates to measure and control counterparty credit risk?

Andrew Bailey (AMCT, MSTA), National Grid Money Markets Team:

There is no simple answer to this problem, but there are a range of measures that corporates can employ to monitor and mitigate their exposures. Counterparty risk management policies have traditionally been based on credit ratings, on the grounds that they provide simple and independent metrics of creditworthiness. However, throughout the financial crisis, market-based indicators have revealed deteriorating credit quality faster than ratings downgrades. Credit default swap (CDS) levels can be used as a leading indicator of distress, using changes in levels as much as the absolute values, although not all CDS prices will be liquid or efficient.

Treasurers should look outside of the individual entity to the wider group and the country of domicile, taking into account potential support from the parent or sovereign in the event of default. If practical, take the time to analyse capital adequacy measures such as tangible common equity (TCE) and Tier 1 capital ratios. However, with the best risk analysis in the world we will still not prevent events of default, so controls must be in place for when the inevitable happens.

Corporates should start with a diversified banking group, spread over geographies and specialisms, with alternative banks able to cover key trading or cash management functions. When investing cash within the group, companies have recently favoured short-dated, high quality investments at the expense of yield opportunities with lower liquidity or credit quality. Corporates can add a layer of security by investing on a secured basis via the repo market, which can also achieve a yield advantage versus unsecured deposits. Longer duration money market funds (MMFs) can exploit an upward-sloping yield curve, while maintaining diversification and liquidity to keep a low credit risk profile.

Within the derivative portfolio, offsets can be identified or created to minimise aggregate exposures. Where possible, trading should take place on a collateralised basis (using bilateral credit support annexes (CSAs) with minimal thresholds, or trading on a cleared basis), while managing potential liquidity risks that may arise from mark-to-market volatility and resultant collateral requirements. Break clauses can be inserted in longer-dated instruments. Companies should also be cognisant of secondary effects of counterparty risk, such as credit value adjustment (CVA) charges, which can in part be managed using credit auctions and options.

Treasurers should maintain vigilance when monitoring the financial health of their counterparties and employ a creative and multi-faceted approach to counterparty risk management.

Rohan Douglas, CEO, Quantifi Solutions:

Firms new to counterparty risk management can learn from early mistakes and benefit from the most recent modelling innovations that improve accuracy and simplify usage. The first step is accurately measuring counterparty exposure.

The most consistent and flexible approach is 'American' Monte Carlo that captures right and wrong-way risk, taking into account the impact of CSAs, collateral and existing positions. Right and wrong-way risks exist when the credit of the counterparty is related to the exposure of the trade with that counterparty.

The CSA terms, collateral posted and existing positions all need to be captured and their impacts measured when calculating counterparty exposure. New models accurately capture the expected future exposure profiles of each counterparty. A second step is pricing the costs associated with counterparty exposure. This includes the CVA and the funding cost adjustment (FVA). CVA measures the expected loss from counterparty default. CVA is needed to match bank counterparty methodologies and is also required by accounting standards. FVA measures the expected cost of funding a margined trade. It is important for evaluating alternate counterparties, CSAs and clearing options. Data and model calibration are often overlooked but play key roles in usability and effectiveness.

Counterparty risk measurement requires a large amount of data – including the terms of all trades with a counterparty, market data required to price these trades, terms of any CSA in place, details regarding collateral posted under the CSA, credit data about the counterparty, volatility information, and information about the relationships between market instruments. This data is both large and changing continually. Accumulation and management of this data is a key driver in the simplicity of implementation and operations of any counterparty risk tool.

Effective measurement and control of counterparty risk starts with accurate measurement, but even the most sophisticated models are not useful unless the right data management tools provide accurate data as input and a simple and transparent calibration process makes the models usable.

Dr. Tim Thompson, Senior Manager, Enterprise and Risk Services, Deloitte:

For a medium-sized to large corporate, the primary risk management goal with respect to counterparty credit risk (CCR) should be to prevent unwanted exposures from developing. That goal informs the measures to be gathered, risk limits, the controls and governance arrangements needed to keep risk within those agreed guidelines and the skill sets of the teams needed to manage the exposure.

The industry standard way to measure CCR is through expected exposure (EE), calculated for various points in time, and with a particular focus on the next 12 months. EE takes into account movements in the underlying risk factors as well as any netting and collateral agreements that the corporate has in place with its counterparties, who will nearly always be the banks that have facilitated particular trades. You need to have a clear view of each counterparties' EE. Limits need to be set to guard against concentrations and, depending on the scale of operations, also at a sector or country level.

For more sophisticated corporates, EE can be modelled using a Monte Carlo or historic simulation approach, while for less sophisticated corporates it may be sufficient to take the mark-to-market value and apply an add-on (based on standard tables available in the Basel II banking regulations, or a one-off Monte Carlo calculation). The key skills sets required for these tasks are market risk and quantitative finance.

However, your team also needs credit risk skills, since you need to understand the probability of default (PD) of your counterparties. Multiplying the EE by the PD gives the expected loss (in the assumption of zero recovery). The more conservative approach will also factor in correlations between counterparties, since the kind of scenario that sees Bank A default will usually involve a deterioration in the credit quality of Bank B (especially if they are in the same country).

From an operational perspective, successful CCR management requires accurate – and as far as possible – automated capture of trade term sheet data into the front office systems and legal information on your netting agreements (ISDAs) or collateral agreements (CSAs) into a collateral system. This information is then combined into a risk system, which is where many firms can suffer from a weak control environment.

Finally, now that some corporates have better credit ratings than their banking counterparties, it is they who should be requiring collateral from the banks, not the other way round. For those firms, it can make business sense to hire resources that can calculate and manage counterparty risk and the associated collateral requirements independently.

Jonathan Chesebrough, Head of Risk Advisory, Royal Bank of Scotland (RBS):

In the past few years we have seen a lot of interest in this topic and are frequently engaging with our corporate clients as they reassess their bank CCR framework. We have heard of a number of corporates being 'full' on some of their counterparty banks, mainly if they evaluate counterparty credit risk by solely using credit rating and/or CDS level. An over reliance on these two measures of credit risk had to be questioned as CDS levels spiked in 2011 and the June 2012 Moody's downgrade of 15 of the 17 major global banks left very few Aa (or AA) rated banks. For CDS, there has been a realisation that the lack of liquidity in the market limits their effectiveness as a gauge of credit risk. Indeed, studies have shown that even the most actively traded names may only have ten to 15 trades per day, indicating that single trades could overly impact CDS prices.

Instead it may be more appropriate to complement a counterparty credit assessment based solely on market indicators with a relatively easy to perform fundamental analysis, including both quantitative and qualitative considerations. Some quantitative measures include looking at: capital adequacy such as Tier 1 capital ratio; liquidity including dependence on wholesale funding, loan-to-deposit ratio, and size of liquidity buffer; core business profitability to ensure the counterparty is running a sustainable business; and asset quality such as Portugal, Ireland, Italy, Greece and Spain (PIIGS) exposure. All of these measures indicate the likely ability of a bank to honour their commitments.

Qualitative measures are harder to implement, but can still complement the quantitative ones. These include assessing: the home government's support to the industry in cases of turmoil; the strength of local supervision and regulators; the home country's bankruptcy and resolution process and rights; and the strength of the company's management. ■

The next question:

"Who should be in charge of IT in treasury?"

Please send your comments and responses to **qa@treasurytoday.com** ecr research

End of the Eurozone in five fatal scenarios

Anyone predicting a positive outcome for the Eurozone crisis, which continues to rumble on without an end in sight, may be accused of reckless optimism. Much more likely is one of a number of 'doom scenarios' – but which one is worth betting on?

Eurosceptic populism is spreading across Europe. It may even be possible to speak of a trend that revolves around everything that is 'anti': anti-globalisation, anti-capitalist and anti-European. National governments are stuck for an answer when it comes to endemic problems, for example massive national debt, growing inequality and political polarisation. A systemic trust crisis undermines the legitimacy of national administrations, parliaments and European institutions – and renders them dysfunctional.

Tensions are mounting between advocates of cutbacks/reforms and champions of fiscal and monetary easing, as well as a lower burden of restructuring. For the moment, these points of view are miles apart but maybe not for much longer: the International Monetary Fund (IMF) itself is changing its tune and a growing number of economists are now coming out in favour of more stimulus. In the meantime, economic problems are on the increase in several core Economic and Monetary Union (EMU) states. The market response is hard to predict.

A positive scenario could unfold as follows:

- The core and periphery of the EMU agree on a new method for tackling the crisis. Fewer spending cuts will be implemented in the near term and the approach will make more sense (education, research, etc will be spared) as job market reforms continue and more markets are opened. In addition, Germany would accept higher wages.
- The markets embrace fresh initiatives as the existing policies do not work.
- The new methods for tackling the crisis bear fruit and growth picks up.

The markets still appear to believe in a happy ending, yet such optimism could prove reckless. It is not possible to ignore the prospect that a negative scenario for the Eurozone will become reality.

Five scenarios

In 2012, Thomas Wright of the think tank Brookings wrote a report entitled 'What if Europe fails?' In his view, things can go wrong in four different ways; to this list is added a fifth 'doom scenario':

1. The Eurozone mistakenly thinks it can survive after 'shedding' one or more member states.
2. Under duress, the Eurozone continues to muddle on. Economic growth stays very sluggish and reforms are rarely carried out. Finally, markets have had enough. Soaring bond yields bring matters to a head.
3. European leaders agree on cutbacks and reforms. Subsequently, these are implemented. The effect is negligible.
4. At European level, states agree on ways to defuse the crisis but at national level the plans hit a brick wall composed of referendums, parliamentary opposition and rulings by the courts.
5. Owing to an economic shock, the entire house of cards collapses – for instance, new large-scale and unforeseen problems in the banking system, which spread like viruses.

Trim down or muddle through?

To start with scenario one, it is not likely that the Eurozone will overestimate its resilience and think the exit of its members is no big deal. In recent years, the Eurozone has been beaten black and blue, and confidence is at a low ebb. In addition to various financial/economic factors, major (geo) political interests are at stake. This will prompt the leaders to make desperate attempts to keep the EMU intact.

Scenario two, or 'muddling on', may sound negative but has allowed the Eurozone to keep its head above water for quite some time. The Eurozone is very proficient at muddling through. At the same time, this strategy is fragile at best and may be approaching its sell-by date. It worked when Greece, Portugal and Ireland were about to plunge into the abyss, but now the markets have shifted their focus to the big players. If the market gets wind that Europe will wriggle out of imposing structural reforms on Italy, Spain and France, interest rates will rise quickly.

New approach doomed to failure?

Equally, the Eurozone can break apart if political leaders were to agree on new ways to tackle the crisis but these measures do not suffice (scenario three). The core and periphery are slightly more likely to find common ground now that many analysts, the media, economists and (national) politicians argue that cutbacks and reforms should be adapted – in terms of timing, scope and content.

Unfortunately, politicians tend to spend political capital in the wrong order. Ideally, the government would start with structural reforms and then follow these up with (sensible) cutbacks. The latter are less desirable than reforms but better than tax increases, eg the third 'remedy' that could help the economies regain their health. Politicians are inclined to start with tax rises, which erode public support for cutbacks. Once they embark on structural reforms, the social base for change has all but crumbled.

Now the Eurozone is in such a bad way that only a combination of the aforementioned instruments could still save the day. Can the Eurozone strike a perfect balance between higher taxes, cutbacks and reforms? Particularly in the light of pervasive populism, growing disillusion among electorates, and steadily decreasing authority of the traditional political and European institutions. An effective cure seems unfeasible in a climate of structurally lower growth, ageing populations and increasing energy dependence. So even if the European political leaders finally manage to work out how to counter the euro crisis, the odds are they will fail.

National obstructionists

That leaves two other scenarios for a doomed Eurozone. Starting with the 'national level scenario' (scenario four), even if the European leaders come up with effective measures, they will need to 'sell' this package to their voters. Roughly speaking, three types of obstacles could hamper a solution:

1. National parliaments are blocking progress.
2. Referendums: 'the people' could well reject further European integration.
3. The judiciary, which could put a stop to European plans: Germany's Constitutional Court was the focus of attention last year and recently the Constitutional Court of Portugal voted down austerity measures.

Banks and lower authorities: an explosive combination

Finally, there is scenario five: a major economic shock that will shake the Eurozone to its foundations and/or tip it into the abyss. If such a script becomes reality, it will probably start with the financial sector or the lower authorities, which are still knee-deep in complicated derivatives and property that has greatly depreciated in value. As to the financial sector, the problems that started in 2007 have not yet been overcome. The financial sector and authorities are still – perhaps more than ever – intertwined.

Many regional and local governments are in dire straits. Local authorities have invested money hand over fist. Without the benefit of higher knowledge, they bought up complex derivatives and vast pieces of land, on the assumption that prices would go up. Of course, this has turned out to be an illusion.

If skeletons are discovered in the cupboards of regional Italy, at a bank of systemic importance in Spain or in a sizeable German Landesbank, this will have far reaching implications for the Eurozone and market panic could spread quickly.

Success not guaranteed

The above shows there is no guarantee that the Eurozone will find its feet again and defuse the crisis. Many analysts assume that Europe cannot fail, simply because they cannot imagine such a scenario. Political leaders, most of whom understand that a European bloc is imperative in a globalised world, will pull out all the stops to overcome the political hurdles. They do not want to be held responsible for the collapse of the European integration project, which has brought peace and prosperity for 60 years running.

Unfortunately, the history of international relations is riddled with failures. Many of these were deemed unthinkable; the presumption was that the politicians would be too sensible to let things get out of hand. Take the (relatively small-scale) disaster of the US budget sequestration, or the cascade of calamities, unfortunate incidents, mounting tensions and narrow-minded leadership that led to World War I.

History is rife with developments and catastrophes that nobody wanted and that could have been prevented – and yet they still happened. Time has not yet run out for the Eurozone and Europe, but let us not underestimate the likelihood of accidental failure.

For now, markets are fairly sanguine. However, this mood is not compatible with the political-economic developments and prospects for Europe. Extremist parties are gaining in popularity, there has been pressure on the axis Paris-Berlin for quite some time, the UK is obstructing developments that are essential for progress, economic stats continue to disappoint, and nobody seems to have a visionary and inspiring plan for Europe that combines pragmatism, economic common sense and political ingenuity.

If disaster occurs, the reasons will most likely be a combination of the aforementioned scenarios: a major bank that collapses or a central government that needs to bail out an entire region or province. In response, the markets will become jittery as the politicians concoct yet another muddle-on strategy. However, there may well come a time when national parliaments start to revolt (under pressure from dissatisfied voters), or perhaps a Constitutional Court will refuse to play ball. As a result, the Eurozone will grind to a halt and unravel. ■

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Flowing eastwards

It is not just China and India that represent opportunities in the East – South-East Asian markets are growing exponentially and are hungry for foreign investment. While these markets may not yet be a large part of an MNC's P&L, they certainly will in the future.

Significant changes in the relative size of the world's economies will take place during the next 50 years, according to the Organisation for Economic Co-operation and Development (OECD). In its November 2012 economic policy paper, 'Looking to 2060: Long-term global growth prospects', the OECD predicted that fast growth in China and India will soon make their combined gross domestic product (GDP) surpass that of the G7 economies and exceed that of the entire current OECD membership by 2060.

Growth in non-OECD countries will continue to outpace the OECD average during the period, although the difference will narrow over coming decades. From more than 7% per year over the past decade, non-OECD growth will decline to around 5% in the 2020s and to about half that by the 2050s, according to the report. Until 2020, China will have the highest growth rate among the countries included in the study, but will then be surpassed by both India and Indonesia. This partly reflects a more rapid decline in the working-age population, and consequently in labour force participation, in China rather than in India and Indonesia.

In the more immediate future, the OECD's 'Interim Assessment' of the global economic outlook, published in March, confirms that growth of emerging economies remains much faster than that of advanced countries on average (albeit with significant differences across countries). The report predicts a return to "moderate growth" in the US during the first quarter of 2013, while a "meaningful recovery" is likely to take longer in Europe.

"Given the substantial share of the world economy now accounted for by emerging economies, they will again drive growth at the global level this year," says the report. "Annualised growth in China is expected to continue to be well above 8% in the first half of 2013."

The United Nation's (UN) assessment of the global economy for the coming year is rather more downbeat than that of the OECD. Its 'World Economic Situation and Prospects 2013', published in December last year, highlights that economies in developing Asia "weakened considerably during 2012" as the region's growth engines – China and India – shifted into lower gear. "While a significant deceleration in exports has been a key factor behind the slowdown, both economies also face a number of structural challenges that hamper growth," states the report. "Given persistent inflationary pressures and large fiscal deficits, the scope for policy stimulus in India and other South Asian countries is limited."

China and many East Asian economies, in contrast, possess much greater space for counter-cyclical policy. In the UN's outlook, average growth in East Asia is forecast to pick up slightly to 6.2% in 2013, from the estimated 5.8% in 2012. GDP growth in South Asia is expected to average 5% in 2013, up from 4.4% in 2012, led by a moderate recovery of India's economy.

While there may be differences in the details, it would be difficult to argue with the idea that developing – or emerging – economies are where the growth is. The moribund economic climates of many of the Eurozone countries, along with those of the UK and the US, do not present attractive platforms on which corporations can grow.

Data collected from purchasing managers across the Eurozone during March 2013 indicate a deepening of the downturn in the currency union, according to Markit's Purchasing Managers' Index (PMI) published in April. Output and new orders fell at stronger rates, driving further job losses. PMIs fell in almost all countries, with a modest decline in Germany, accompanied by steep downturns in France, Spain and Italy.

East Asia evolves

The austerity-hit developed economies stand in stark contrast to the vibrant and dynamic countries of the world's Eastern hemisphere, which is characterised by younger populations and growth-friendly economic policies. In the past few years, the idea that the East was a region from which to source cheap labour, has given way to a realisation that it is also a region of other opportunities, with burgeoning consumer markets and in some cases very significant infrastructure projects under way.

"Asia is becoming the global engine of economic growth, a position further highlighted since the global financial crisis," says Sameer Sawhney, Global Head of Transaction Banking, ANZ. "This growth is sustainable and an increasing number of Western corporations are looking to Asia as a key growth market for their businesses."

For example, San Francisco-based GAP, one of the largest clothes retailers in the US, began an aggressive expansion into China in 2011 as part of a global strategy. The company plans to have around 45 outlets in China by the end of this year as it seeks to reduce its dependence on North America, where consumer confidence is volatile.

Diane S. Reyes, Global Head of Payments and Cash Management at HSBC, says the bank is "bullish" about China's outlook; the country has been a key contributor to world economic growth and that looks set to continue with more than 7% GDP growth for 2013. "Firms that want to grow in the global economy should be involved in China and using the renminbi (RMB)," she says. "Currently, more than 10% of China's international trade is settled in RMB, and by 2015 we expect that over one third of all international trade transactions with China will be denominated in RMB."

As a very big consumer-oriented market, there are "tremendous" opportunities in China for retail companies to expand, but they need to understand the market and its settlement conditions, and potential complexities that vary city by city.

Reyes says the pace and scale of urbanisation in China is extraordinary. "This trend therefore provides significant opportunities for companies involved in infrastructure development as China continues to invest heavily in housing, transportation, telecommunications and other infrastructure projects to enable people to move into cities."

In September 2012 China's economic planning authority, the National Development and Reform Commission, announced approvals for 60 infrastructure projects worth a total of $150 billion. The projects include highways, ports and airport runways. Financial news service Bloomberg reported a surge in the share price of infrastructure companies around the world following the announcement, with Japanese and US companies recording significant jumps.

China is not the only country that is going for infrastructure growth as governments throughout the region instigate large-scale projects. The Indonesian government, for example, has announced plans to float tenders for several medium-to-large infrastructure projects worth $7.6 billion in 2013. The move, aimed at boosting economic growth, will cover projects such as toll roads and dams, construction of which is expected to begin by 3Q13. In Vietnam, the government has announced a large project to build a high capacity electrical transmission line for 437kms across a number of provinces and through to Ho Chi Minh City in the south. It aims to ensure electricity supply to the southern areas of the country by 2014-2015, as well as power grid connectivity across Vietnam, Laos and Cambodia by 2015.

Beyond China

It is not just China and India that represent opportunities in the East. In a 2011 report, 'The Time for Regional Expansion is Now', Accenture identified South-East Asia as an emerging prime business destination in Asia. Brunei, Cambodia, Laos, Indonesia, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam offer multinationals new markets in which to pursue growth, the report says. After India and China, South-East Asia is regarded as the third pillar of Asia as a whole.

Accenture says the region is perceived to be a long-term destination that will remain on the periphery of an Asian strategic agenda for a majority of businesses outside the region, but at the centre of expansion plans for native businesses seeking growth closer to home.

"We believe businesses that position themselves now for growth in South-East Asia will be rewarded by finding themselves in the middle of a new 'centre of gravity' within future high-growth markets," says the report. "South-East Asia has the clear potential to become an alternate hub to China within the Asian region. It offers new opportunities for international companies and can act as a launch pad for local businesses seeking to become regional or global leaders."

Businesses that are gravitating towards expansion into South-East Asia should focus on four key imperatives:

1. Adopt a regional mindset.
2. Develop strong partnerships.
3. Adapt from the core.
4. Move with agility.

Because of its sheer scale China dwarfs every other country in the region, says Sawhney. But from a strategy point of view, other markets of interest include Indonesia, the Philippines, India and Vietnam. "These markets are growing exponentially and have stable political and regulatory environments and are hungry for foreign investment."

Domestic markets in the East are becoming more vibrant; India has a population of 1.3 billion and Indonesia has 230 million people. "We are moving away from the term 'emerging market' to one of 'growth market'," says Sawhney. "While these markets may not yet be a big part of a company's P&L, they will be in the future. In Vietnam, for example, 65% of the population are under the age of 20."

Challenges

Expanding into Eastern markets is not without its challenges, of course. "Asia today is very much like Europe of the 1980s and 1990s – it has many different markets, economies, currencies and taxation regimes," says Richard Jaggard, Managing Director and Head of Transaction Banking Europe, Standard Chartered. "Corporate treasurers' first challenge is how to manage such complexity – many have gone down the regional treasury route, others are managing Asia from their European or US headquarters. As their scale of business grows in Asia, treasurers realise they have to put more high quality resources into the region in order to manage the increased complexities and risks that come with commercial growth."

Corporates want to use the structures they have developed in the West and blend them into Asia, says Jaggard. For example, they are looking to 'bolt on' Asian operations to the liquidity structures they have developed in Europe. This will enable them to centralise cash from the region – some are doing this via a regional treasury centre (RTC), others are looking to integrate into a global structure. For non-mobile liquidity, corporates are focused on in-country efficiency via approaches such as yield enhancement based on aggregated positions within the region.

ANZ's Sawhney says there are changes afoot in Eastern markets that make them very interesting for corporate treasurers. "In the past Asia was a factory for the world with uni-directional flow to the West, as companies sourced from Asia. There was no significant currency risk as the majority of transactions were in US dollar or euro. Now, however, there is increasingly a two-way flow as companies look to supply to Asian markets. Funding flow and allocating capital are becoming key differentiators."

RMB strategies

Corporations looking to do business in the East will at some stage have to develop a strategy for China's currency. "The internationalisation of the RMB is posing issues for corporate treasurers to work through in terms of managing investments and cash," says Sawhney. "To date there are still only three fully convertible Asian currencies – the Hong Kong dollar, Singapore dollar and Japanese yen. The biggest growing markets in the East – China and India – do not have open currencies."

HSBC's Reyes says the Chinese regulators are looking to ease currency inflows so corporates can raise RMB funding in Hong Kong or another market, and use that to fund projects in China. This will help corporates to limit their foreign exchange (FX) exposures. "A challenge when dealing with the RMB is whether to go onshore, with accounts in China, or offshore in Hong Kong, for example," she says.

Jaggard says a significant challenge for corporations doing business in China is what to do with the cash they generate there. "During the past few months the Peoples' Bank of China (PBoC) has taken a few more steps in its RMB liberalisation programme, such as the ability to make short-term foreign currency loans. This will help."

In April, Australia became the third country, after the US and Japan, to seal a currency deal with China. It means the Australian dollar can be converted directly into RMB. China is Australia's main trading partner, with exports and imports totalling A$120 billion in the last financial year.

A survey of 500 small and medium-sized enterprises (SMEs) in Australia, conducted by HSBC, found that 40% of companies importing from or exporting to China intend to settle transactions in RMB during the coming year. The currency deal between Australia and China will reduce costs, as firms will no longer have to convert via the US dollar. According to the survey, 31% of SMEs plan to use both US dollar and RMB, and 13% intend to exclusively use the Chinese currency. "Given China represents over 20% of our current trade and is expected to grow by 8.5% per annum to 2020, the RMB's role within Australian trade will inevitably rise," said HSBC Bank Australia Head of Business Banking, Paul Edgar, in a statement. "It is clear from the survey that Australian SMEs are getting ahead of the curve."

Treasury strategies

Growth rates in the faster growing economies are very attractive, but treasurers realise they need to develop efficient infrastructure that will support growth, says Jaggard. "Centralisation through the development of skills centres, such as RTCs, provides the opportunity to identify and manage financial risk, while shared service centres (SSCs) focused on accounting and payments provide processing efficiency gains as well as quality in information management. Both are important parts of building scalable platforms for growth regionally, and increasingly globally," he says.

Most of the multinational companies (MNCs) now operating in the East realise that it is not possible to run a global treasury to cover everything centrally out of one market, says Sawhney. "There is a huge amount of activity with companies opening RTCs to take advantage of the depth of the markets in terms of liquidity, currency and interest rates. There is also significant advantage in being in the same time zone.

"Asia is awash with liquidity and represents a big opportunity to run medium to long-term money at attractive prices", he adds. Companies realise they can fund business from the liquidity pools in the regions where they are growing.

Sawhney cautions companies entering Eastern markets to ensure they understand the relevant regulatory and cultural environments. "The pace of change is so rapid in the region that what might have been best two years ago is no longer the case. I believe that this is why regional banks are gaining in importance – partnering with a local bank in each country is too unwieldy, so working with regional banks that have a strong footprint across countries is key." ■

Tamer Karabulut

Head of Treasury Operations

Türk Telekom Group, the leading communication and convergence technology group in Turkey, provides integrated telecommunication services from PSTN and GSM to broadband internet. As of 31st December 2012, Türk Telekom group companies have 14.3m fixed access lines, 7m broadband connections and 13.5m mobile subscribers. Group companies have a modern network infrastructure covering the whole country and offer a wide variety of services to residential and commercial customers all over Turkey.

Problem…

Türk Telekom has more than 300 offices countrywide, of which each collects cash from subscribers. The company's main cash management challenge was to collect the funds from these offices and deposit them into the HQ current account. In the previous cash management set-up, there were three ways to collect cash: pick-up by armoured cars from 165 offices; deposit into an account held with a state-owned bank, for further transfer to the HQ account and direct debit from dealers. The first two collection methods were at the root of the problem, effectively having a negative effect on cash flow visibility, predictability and usage.

Firstly, the cost for armoured car collections was considerable and there was a growing dissatisfaction with the service level. There was also significant inefficiency built into this model in terms of working capital management because the cash was picked up from the offices daily at 5pm. Türk Telekom could not utilise the cash on the same day, which meant the company was sitting on an excess of idle cash.

Secondly, the company faced a delay when offices used the bank deposit method. "Our offices went to the state-owned bank and deposited cash into their accounts, and the bank then transferred the money to Türk Telekom's HQ account," says Tamer Karabulut, Head of Treasury Operations, Türk Telekom. Consequently, it would normally take one day for the amount to show up in the HQ account. In addition, Türk Telekom wasn't able to determine the amount collected per unit each day. As a result, the treasury's cash flow forecasts were not accurate.

Hence, the company decided to explore alternative collection channels to reduce costs and accelerate and improve the efficiency of the cash collection process.

…Solved

Türk Telekom reached out to its banking partners for a solution, but most came back with the same cash management structure, including armoured car collections – some offering a slightly lower price. However, the company was really looking for an innovative solution that would be preferable in terms of cost and efficiency. Citi was the only bank to come up with an innovative solution. The solution leverages Citibank A.S. Turkey's partnership with Post Bank of Turkey (PTT), which has 4000 online branches countrywide, effectively the largest branch network in the country.

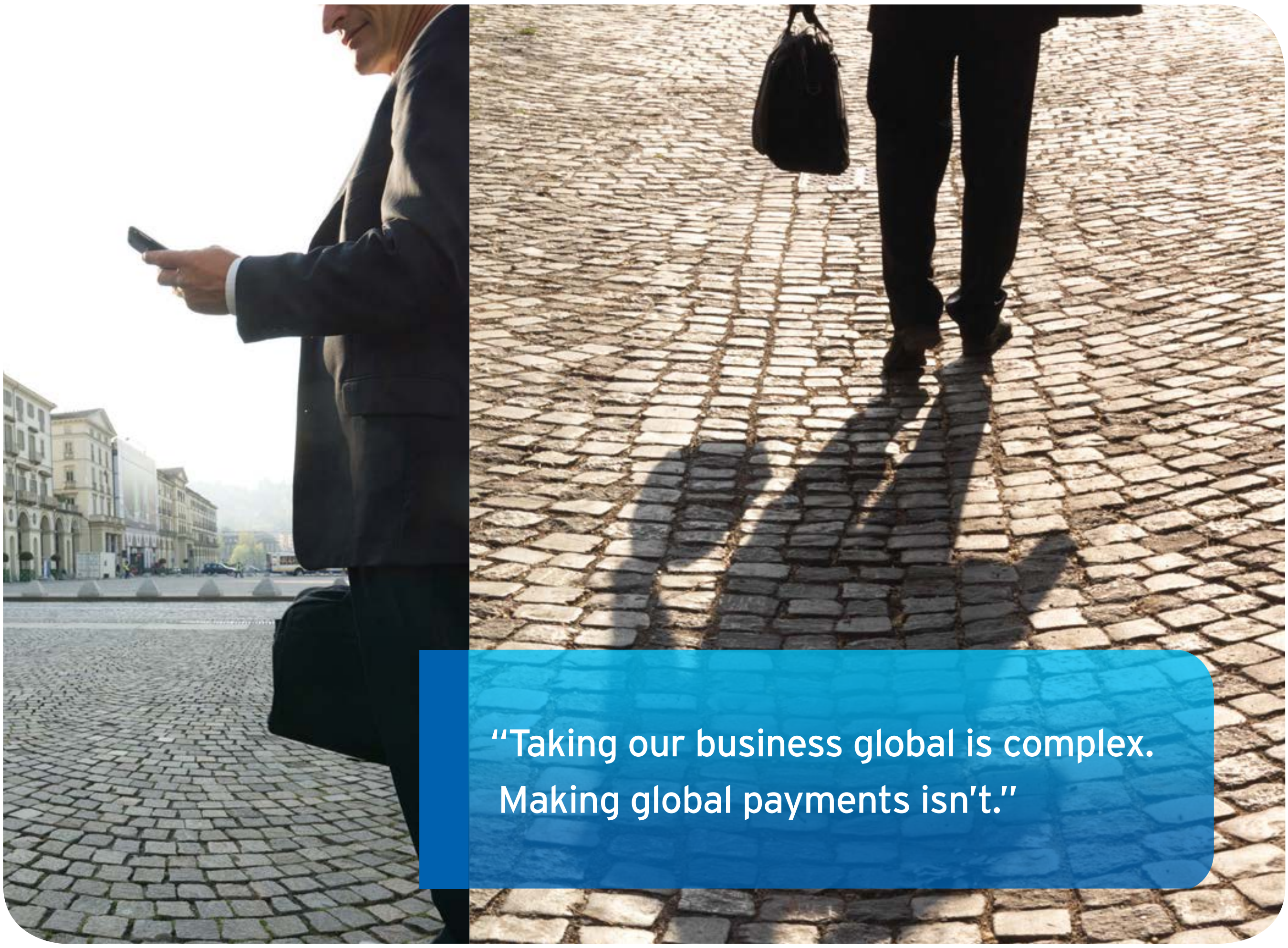
Citi's corporate clients can benefit from cash deposit transactions. For Türk Telekom this was a particularly ideal solution as they share the same offices with PTT in many locations, as a result of being a business unit of PTT before being hived off as a separate company in 1995 and privatised in 2005. The physical proximity of the locations effectively eliminates the burden of moving cash and reduces the cash collection costs by nearly 20%.

In the PTT branches, with the custom designed Citi collection screens, offices can deposit cash until 5pm local time. Cash deposit transactions are performed in a straight through process (STP) on PTT teller screens. Identification details of the depositors are then saved in a database and this data is automatically displayed for future transactions, which makes the transaction entry process more efficient.

When a cash deposit is made, Türk Telekom treasury can see the amount in their accounts online, same day, as well as how much each office has deposited. "Because we can monitor all the cash inflows, we are now able to forecast the future," says Karabulut. Implementation of the solution has had a positive impact on the cash collection process of Türk Telekom in terms of efficiency.

Türk Telekom can automate incomings reconciliation and increase efficiency thanks to a tailor-made reconciliation tool in which Citi combines a standard MT940 SWIFT message with corresponding transaction codes of Türk Telekom. The project began in June 2011 and the first transaction was realised in November that year. Treasury set up the new process and informed their offices.

The company opted for a phased regional roll out and completed on-boarding all of the eligible offices by August 2012. Today, Türk Telekom is using Citi's solution at 145 points through post offices countrywide. Monthly volume has reached TRY17m, with a total number of 2500 transactions. Citi is now looking at developing a solution for offices in locations that are not covered by PTT. ■



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John Maynard Keynes

The 2007/8 global financial crisis shattered the dream of unfettered free market capitalist expansion, as countries around the world responded by switching to the default position of Keynesianism – deploying stimulus packages to help prop up their domestic economies. Treasury Today takes a look at the man behind the 'ism', John Maynard Keynes, and his contribution to economic theory.

Seminal works

- **Indian Currency and Finance (1913)**
  Keynes outlines how changing from a silver to a gold standard impacted the Indian economy, defined governmental policies regarding reserves and cash balances, and described the workings of India's monetary system. It contains a description of the 'gold exchange standard'.

- **The Economic Consequences of the Peace (1919)**
  In this book Keynes criticises the exorbitant war reparations demanded from a defeated Germany and prophetically predicted that it would foster a desire for revenge among Germans. This best-selling book made him world famous.

- **A Tract on Monetary Reform (1923)**
  Keynes recommends the depreciation of sterling to boost jobs by making British exports more affordable. From 1924 he also advocated a fiscal response, where the government could create jobs by spending on public works and called for an end to the gold standard.

- **A Treatise on Money (1930)**
  Keynes draws a distinction between savings and investment, arguing that where saving exceeded investment, recession would occur. Thus, he reasoned that during a depression the best course of action would be to promote spending and to discourage saving.

- **The General Theory of Employment, Interest and Money (1936)**
  Keynes develops interventionist policies for tackling a recession. This book challenged the earlier neoclassical economic paradigm, which had held that the market would naturally establish full employment equilibrium, provided it was unfettered by government interference.

- **How to Pay for the War (1940)**
  Keynes argues that the war effort should be largely financed by higher taxation and especially by compulsory saving (essentially workers lending money to the government), rather than deficit spending, in order to avoid inflation.

John Maynard Keynes, a British economist, was so important to the theory and practice of the economics that an entire school of modern thought bears his name. His book, 'The General Theory of Employment, Interest and Money', is often viewed as the foundation of modern macroeconomics and many have hailed him as the most influential economist of the 20th Century.

His theories caused great upheaval in the world of economics, dubbed the Keynesian Revolution, and his economic policies dominated during the latter part of the Great Depression, World War II and the post-war economic expansion (1945–1973). The rise of Keynesianism marked the end of laissez-faire economics, which is based on the belief that markets and the private sector could operate efficiently without state intervention.

However, Keynesianism fell out of favour in the 1970s, when many Western economies were hit by stagflation – which is when both unemployment and inflation increase at the same time – and the deteriorating economic conditions after the 1973 oil crisis. Doubtful about the ability of governments to regulate the business cycle with fiscal policy, Milton Friedman led the attack against Keynesian economic policies, alongside monetarists and neoclassicalists such as those trained at the Chicago school of economics.

Today, the global financial crisis has stoked a Keynesianism resurgence. Most countries, including the US, the UK and China, undertook government interventionist policies in response to the crisis. While the US and UK used their stimulus packages to bail out the banks, China pledged a similar amount as the US ($586 billion) in key areas such as housing, rural infrastructure, transportation, health and education, environment and industry.

These stimulus plans have been credited for contributing to a better-than-expected economic outlook by both the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF).

As a result, Keynesianism has been rehabilitated in the eyes of economists worldwide. In March 2008, macroeconomist James K. Galbraith disputed the consensus of monetarist economics and argued that Keynesian economics were "far more relevant" for tackling the emerging crises.

Joseph Stiglitz, Robert Reich, George Akerlof and Brad DeLong are among other distinguished economists that have argued for Keynesian government intervention to mitigate the financial crisis. By the end of December 2008, the Financial Times reported that "the sudden resurgence of Keynesian policy is a stunning reversal of the orthodoxy of the past several decades."

Background

Keynes was born on 5th June 1883 in Cambridge, England to an upper middle class family. His father, John Neville Keynes, was an economist and a lecturer in moral sciences at the University of Cambridge. The younger Keynes won a scholarship to Eton College in 1897, where he studied mathematics, classics and history.

In 1902 Keynes left Eton for King's College, Cambridge after receiving a scholarship to study mathematics under economists Alfred Marshall and Arthur Pigou, whose scholarship on the quantity theory of money led to Keynes's Tract on Monetary Reform many years later. Keynes was also interested in philosophy, especially the ethical system of G. E. Moore.

Keynes joined the Civil Service in October 1906, as a clerk in the India Office. In 1908 he resigned his position to return to Cambridge and work on probability theory, at first privately funded only by two dons at the university – his father and Pigou. In 1909 Keynes published his first professional economics article in the Economics Journal, about the effect of a recent global economic downturn on India. That same year, Keynes accepted a lectureship in economics funded personally by Marshall.

In 1911 Keynes was made editor of the Economic Journal. In 1913 he published his first book, 'Indian Currency and Finance', and was then appointed to the Royal Commission on Indian Currency and Finance.

In an appointment that marked his career, Keynes was financial representative for the Treasury to the 1919 Versailles peace conference. At Versailles he argued against setting Germany's compensation payments so high that it would encumber innocent German people, make it impossible for the nation to pay its debt and limit its ability to buy exports from other countries, as a result negatively impacting not just Germany's economy but that of the world. He was not successful in his endeavour and resigned from the Treasury in disgust.

During the war years, Keynes played a decisive role in the negotiations that were to shape the post-war international economic order. In 1944, he led the British delegation to the Bretton Woods conference, which established the World Bank and the IMF and put in place a system of fixed exchange rates. He died in 1946. Throughout his multidimensional career Keynes was also a director of the British Eugenics Society, a director of the Bank of England, a patron of the arts and an art collector, an advisor to several charitable trusts, a writer, a philosopher, a private investor, a farmer, and a part of the Bloomsbury Group of intellectuals. Bertrand Russell named Keynes one of the most intelligent people he had known, commenting, "every time I argued with Keynes, I felt that I took my life in my hands and I seldom emerged without feeling something of a fool."

Keynesian economics

The theories forming the basis of Keynesian economics were first presented in 'The General Theory', published in 1936 during the Great Depression. Prior to this, mainstream economic thought was that the economy existed in a state of general equilibrium – that the economy naturally consumes whatever it produces because the needs of consumers are always greater than the capacity of the economy to satisfy those needs. The idea that supply creates its own demand is reflected in Say's Law. This perception rests on the assumption that if a surplus of goods or services exists, they would naturally drop in price to the point where they would be consumed.

The General Theory, on the other hand, argues that demand, not supply, is the key variable governing the overall level of economic activity. Aggregate demand, which equals total un-hoarded income in a society, is defined by the sum of consumption and investment. In a state of unemployment and unused production capacity, employment and total income can be enhanced by first increasing expenditures for either consumption or investment.

The book advocates interventionist economic policy by government to stimulate demand in times of high unemployment, for example by spending on public works. "Let us be up and doing, using our idle resources to increase our wealth," Keynes wrote in 1928. "With men and plants unemployed, it is ridiculous to say that we cannot afford these new developments. It is precisely with these plants and these men that we shall afford them."

Keynes' theory overturned the mainstream consensus at the time and brought about a greater recognition that unemployment is the result of a structural problem inherent in the economic system. He argued that because there was no guarantee that the goods that individuals produce would be met with demand, unemployment was a natural consequence. However, economists still argue today about what Keynes thought caused high unemployment.

Rather than having a negative view of unbalanced government budgets, Keynes supported countercyclical fiscal policies, which are policies that work against the cyclical tendencies in the economy. These include deficit spending when a nation's economy suffers from recession or when recovery is slow and unemployment is persistently high, as well as the suppression of inflation in boom times by either increasing taxes or cutting back on government outlays. He argued that governments should solve problems in the short term rather than waiting for market forces to do it in the long term.

Conclusion

Contrary to some of his critics' assertions, Keynes was a strong advocate of free markets. He believed that once full employment had been achieved by fiscal policy measures, the market mechanism could then operate freely.

So despite sparking a revolution in economic theory and practice, Keynes wasn't for the overthrow of the capitalist system. In 1999, Time magazine included him in its list of the 100 most important and influential people of the 20th Century, commenting that, "his radical idea that governments should spend money they don't have may have saved capitalism." ■

Branches of Keynesianism

- **Neo-Keynesian.** An attempt to interpret Keynes' ideas and synthesise with the neoclassical models.
- **New Keynesian.** Strives to provide microeconomic foundations for Keynesian economics.
- **Post-Keynesian.** Attempt to get back-to-the-basics of The General Theory.

treasurytoday Business Briefing

Globalising corporate liquidity structures to maximise potential funds

The shifting focus of global commerce and a changing and variable regulatory environment are driving businesses to look much closer at their liquidity and risk management processes. While many multinational organisations are currently flush with cash, they are concerned with optimising future sources of liquidity. This is forcing companies to focus on improving their approaches to be able to make use of internal funds, while optimising and controlling the deployment of excess cash. Given these dynamics, the distributed regional and currency specific liquidity structures are no longer in favour.

Best-in-class companies are achieving optimisation through the centralisation and globalisation of their liquidity management and account structures. But this cannot be achieved in isolation. In adopting this new liquidity strategy, businesses need to ensure that the approach to liquidity management is integrated with the accounts payable (AP) and receivable (AR) processes.

Historically, companies operating globally would manage their liquidity on either a regional or single currency basis (or both). The adoption of the segregated model was more a reflection of the tendency for treasury organisations to be decentralised and the lack of tools available to support a more centralised approach. This reflected not only the technological limitations of the day, but also the stage of evolution of corporate treasury in general, which after the financial crisis in 2008, assumed a more strategic role.

"Managing through the crisis made both the CFO and the treasurer strategically more important to company interests, especially from a risk management perspective," says Tom Schickler, Global Head of Liquidity for HSBC's Global Payments and Cash Management business. "And as the treasury function became more important, centralising treasury suddenly became a strategic imperative." The desire for centralisation coincided with improvements in the banking solutions available to support their requirements.

Funding constraints in the risk and regulatory environment

Emerging from the financial crisis in 2008, heightened concerns from a risk management perspective have accelerated the trend towards globalisation of liquidity management. Companies are seeking means by which to manage their counterparty and sovereign exposure, while ensuring that they have multiple sources of liquidity (not only relying on internal sources of funds). As a consequence, companies are looking beyond visibility and control to securing access to liquidity on a real-time basis in order to be able to respond to market events.

Recent developments across Europe (eg. Cyprus) have reinforced the importance of being able to gain access to liquidity on a timely basis, and furthermore to set up a foundation of liquidity management that reflects the companies risk management orientation. In addition to counterparty and sovereign risk, liquidity risk has also manifested itself in the past decade as money markets have not remained liquid during certain flashpoints. The situation has been acerbated by the constrained availability of cash from banks. The gridlock in the money markets that hit Europe in 2008 and 2009 and then again in 2011 and 2012, certainly raised concerns amongst companies, leading many to focus on accessing their own cash across all of their centres.

But handling the risk dimension is only part of the game. The evolving banking regulatory regime poses an additional funding consideration for corporates. As the increased capital requirements of Basel III come to fruition, it will place constraints on bank balance-sheet capacity. This will increase the cost of bank borrowing for companies over the long term. On an absolute basis, with interest rates currently running low, the cost of borrowing may be perceived to be low. However, it may prove to be relatively more expensive than heading in an alternative direction such as the debt and equity capital markets, raising funds through private equity or other non-traditional lenders – a move taken by increasing numbers of corporates.

In response, treasurers have learnt to prioritise the need to create or at least supplement the mechanisms they use to self-fund. But if they do this, it means putting in place a sound liquidity management structure; augmentation usually means shifting from the historical regional or single currency-based approach to a global approach, which implies certain control issues.

Control, visibility and access

"In the past decade or so there has been an emphasis on visibility and control," notes Schickler. "It's one thing to have visibility but the more important issue that companies are wrestling with – and some, but not many, are actually attacking – is the element of access to cash when it is needed." A global treasurer may have a multi-bank report stating the existence of money in multiple countries, but if a crisis hits just knowing there is money out there does not help. The need, states Schickler, is to get hold of that money immediately and be able to do something constructive with it. "It is no longer just about visibility and control; it is also now about timely and efficient access."

This realisation puts a premium on globalising liquidity management, especially consolidation of accounts in unregulated and less-regulated markets and preferred domiciles, but doing so in a way that minimises cash fragmentation. "Corporations need to consolidate liquidity positions as part of their goal, but they should avoid creating inefficiencies in their accounts payable (AP) and receivable (AR) processes as a consequence of that," warns Schickler. By shifting these functions to one country without considering precisely the value, location and timing of payments in another, funding may not now be readily available. "Corporates need an automated structure that has the ability to fund those payments on a just-in-time basis, so they reap the benefits of having consolidated their liquidity position while still being able to meet their daily payment obligations."

It is clear that where consolidation has not been managed effectively, it can put pressure on the treasury and finance functions which will need to counteract the negative effects by increasing to pinpoint accuracy their cash forecasting results. "But if you integrate your liquidity management approach with your AP and AR processes on a seamless and automated basis, you can get the best of both worlds; you don't then have that operational requirement and process or that forecasting need."

Bank differentiation

Banks differentiate themselves not by the availability of their liquidity management technology but more on their ability to apply that technology to develop a solution that is bespoke for a particular client based on its own liquidity management priorities and that aligns with its AP and AR processes. With a combination of local cash management capability that is fully integrated with a global liquidity platform, "HSBC is uniquely positioned to connect our clients' liquidity across developed and developing markets," says Schickler.

Market liberalisation

Market liberalisation programmes in certain countries – and the opportunity to leverage the benefits afforded by unlocking trapped cash and improving working capital efficiency – should be a catalyst for companies to review their existing local account and liquidity management structure, urges Schickler. Getting the foundation right, to take advantage of the anticipated liberalisation, will allow a company to integrate cash into their global structure as soon as the new regulatory regimes finalise their changes.

Recent developments in China, for example, have seen the State Administration of Foreign Exchange (SAFE) and the Chinese central bank, the Peoples' Bank of China (PBoC), approve pilot schemes to enable cross-border sweeping of both foreign currency and renminbi (RMB). The pilot currently involves five international banks, including HSBC, and 13 large corporates, all of which have worked closely with the regulators in the design and implementation of the scheme. As the pilot progresses into broader commercial availability, a greater number of companies will be able to reduce their trapped cash in the country, notes Schickler.

He believes that schemes such as this are, or should be, creating a priority for companies to put the right foundation in place from a domestic cash management and liquidity management perspective, "in order to take advantage of the future capability to integrate local liquidity with the rest of their global liquidity."

Taking the long view

Globalisation is not something that companies can flick a switch and get done; it is an evolutionary process. Depending on where each company is in the evolution of its own treasury management processes there will be an ongoing need for consultation and revisiting existing structures. Liquidity management will never be a "fire and forget" process; it demands continuous attention. "Remember that Basel III is still in the early stages of implementation. Each jurisdiction will interpret it and impose regulations based on its own particular interests and priorities," warns Schickler. As a consequence, there will be a continuous need to respond to those developments by prioritising and making use of different tools.

As the regulatory environment continues to evolve in the banking and in the corporate space, it will impact on the dynamics of areas such as the money markets and other investment options. These changes will conspire to require companies to have a foundation, from a treasury and liquidity management perspective, which gives them the flexibility to respond in a timely manner.

Regulations and economic drivers are rarely fully-aligned across markets and so monitoring, understanding, interpreting and responding to them is an ongoing challenge. It requires a partnership between bank and client enabling full and frank dialogue, says Schickler. The capacity for HSBC to leverage its extensive local presence and expertise is its stock in trade when it comes to making sense of these events and translating them into practicable solutions for corporate clients.

Brendan McGraw

Group Treasurer at CLSA

Case study

CLSA is one of the leading and longest-running independent brokerages in Asia and one of the world's largest agency brokers. It operates three main business activities – equity broking, asset management and investment banking.

Headquartered in Hong Kong and represented in 21 locations across Asia Pacific, Europe and the US, CLSA is a research-driven business with a global reach.

Formerly owned by Crédit Agricole CIB, 19.9% of CLSA shares were acquired by CITIC Securities International Company Limited, a wholly-owned subsidiary of CITIC Securities Company Limited ('CITICS') in July 2012. The deal incorporated an agreement for the acquisition of the remaining 80.1% of CLSA through a put option. This is expected to receive regulatory approval and be completed by the end of June 2013. The deal, in total, represents a valuation of $1.25 billion. CLSA has established stand-alone brokerages in Japan and the US as part of the transaction from Crédit Agricole to CITICS

CLSA has enhanced its cash management solutions through diligent treasury management, the application of sound technologies and through the support of a banking partner that has made a concerted effort to work with the company.

> "What we really liked about HSBC was their preparedness to adapt their cash management models to fit in with what CLSA did rather than the other way round."

CLSA naturally went to market to find the most suitable partner and the quickest response came from the bank with the best solution. But the partnership it chose is not just about a set of clever IT solutions. "Technology has a role to play, but a lot of banks have similar technologies, or they can adapt them to fit," explains CLSA's Group Treasurer, Brendan McGraw. "What we really liked about HSBC was their preparedness to adapt their cash management models to fit in with what CLSA did rather than the other way round."

By partnering with HSBC to build out the right structure for operational efficiency, CLSA has established the path of its progress, assuring itself of access to a global operational network. A key part of the relationship is the alliance of this network with the in-depth local knowledge that the bank brings; HSBC obviously has a strong presence in Asia and, in the words of McGraw, "having boots on the ground has really helped us".

Over the past few years CLSA has worked with HSBC on a number of projects, all driven by a general need for greater efficiency. Not least of these is the deployment of the bank's Integrated Payables Solution. This has enabled the centralisation and streamlining of CLSA's accounts payable management processes. Using an HSBC-supplied adaptor to interface between the bank's internet banking platform, HSBC*net*, and CLSA's SAP general ledger system, most payments processes can now be executed through the firm's Hong Kong headquarters.

Prior to HSBC's involvement, CLSA's management of cash was similarly left to the individual entities. This resulted sometimes in an imbalance between debit and credit positions across their businesses, with some entities operating with short positions and requiring funding, whilst others ran positive cash positions. McGraw presided over the implementation of a regional pooling structure for CLSA spread across nine Asian markets and based on HSBC's Global Liquidity Solutions ('GLS') platform. This, he reports, has enabled CLSA to "cut its borrowing quite substantially."

The regional structure features two multi-currency notional pools – one for entities inside of Hong Kong and one for those outside, this split being driven by a quest for tax efficiency. The pools are used to consolidate and offset mismatching positions across the firm's business entities and obviate the need for individual entities long on cash to concern themselves with the demands of investing that cash. Also put in place is HSBC's Interest Enhancement facility. This is a global cross-border virtual pooling solution that pays, as the name suggests, an enhanced interest rate on CLSA's total operational balances. On the FX side, McGraw reports that bank and CLSA are working together on building a more efficient currency trading system.

> "They've helped us to enhance our processes by bringing more robust cash management solutions."

The pre-implementation work for each project to date featured intensive "brainstorming" sessions between client and bank, each time creating a detailed requirements definition. HSBC then returned with a practical proposition, a dedicated project team and a fully-formed project management approach. The latter, although within the confines of the standard HSBC approach, notably allowed the flexibility to meet CLSA's individual needs – each time working backwards from the planned objective and deadline to incorporate all the essential milestones and timelines.

The rigour of each planning stage ensured that HSBC's solutions were able to integrate comfortably with CLSA's existing processes and technologies. "If anything, they've helped us to enhance our processes by bringing more robust cash management solutions," comments McGraw.

The pooling structure still requires some work before bringing all parties on board and the conversation between CLSA and HSBC is thus ongoing. The rise of the US and Japanese brokerages will likely see the growth of each entity's own cash production and funding needs which will make them natural targets to join the cash pool. "We've done a very good job on this, but there are a few more steps to go," adds McGraw. The partnership, it seems, is assured for some time to come.

Tom Shickler

Global Head of Liquidity

Tom Schickler is based in Singapore and is responsible for the strategy and development of Liquidity and Investment products for HSBC's Global Payments and Cash Management business. He has extensive product, sales and operational management experience in Asia Pacific, Europe and the US, having spent 20 years working in the banking industry. All of his roles have focused on wholesale banking, and have involved working with Financial Institution and Corporate clients.

Schickler is also a Board Member of the National Payment Corporation of India, for whom he is the Chairman of the Risk and Audit Committees.

HSBC Global Payments and Cash Management

HSBC Global Payments and Cash Management provides cash management services to customers globally, including Fortune 500 multinational companies, top-tier local corporates, middle market companies, SMEs, financial institutions and government bodies.

HSBC Holdings plc

HSBC Holdings plc, the parent company of the HSBC Group, is headquartered in London. The Group serves customers worldwide from around 6,600 offices in 81 countries and territories in Europe, the Asia Pacific region, North and Latin America, and the Middle East and North Africa. The HSBC Group is one of the world's largest banking and financial services organisations.

HSBC

A credit to the industry

David Vermylen
Global Credit Manager

David Vermylen is Global Credit Manager for BP Petrochemicals. Under his guidance, the work of the credit department has shifted from something of a 'back-office exercise' to one that is 'on the move all the time, restructuring and adapting to the changing environment'. The broader sweep of its remit has a lot to do with Vermylen's career path. Having started his professional career in 1995 with Price Waterhouse, he moved through a progression of formative roles, from banking securities, power trading (with none other than Enron) into the largest credit analyst portfolio inside BP Chemicals. The call to his current position within the BP Petrochemicals unit came in early 2005.

BP is one of the world's leading international oil and gas companies. It operates through subsidiaries, branches, joint ventures and associate businesses across 28 countries, employing more than 85,000 people. Turnover in 2012 exceeded $375 billion.

Its stock in trade is spread across two distinct segments. BP's Exploration and Production segment exists to find, extract and transport oil and gas. Its Refining and Marketing (R&M) segment develops these raw commodities into a diverse range of applications such as fuel for transportation (including aviation fuel), energy for heat and light, lubricants and, through its petrochemicals division, chemicals that act as base for hundreds of industrial and consumer products. Rarely co-located with BP's refineries, as a strategic performance unit within R&M, the petrochemicals division has three plants in the US, two in Europe and nine production units in Asia.

Much as sales people would have you believe otherwise, a sale is not a sale until it has been paid for. Supplying customers without the certainty of getting paid is a high risk venture. A vast international organisation such as BP is not going to go under if a few of its customers default, but considering the size of some of its deals, strong credit management is still a vital part of its operations. A business of this size and footprint demands something a bit special on the credit management front.

"It's a unique and interesting set-up," confirms David Vermylen, Global Credit Manager for BP Petrochemicals. Having shifted about six years ago from a mostly regional to a mostly centralised model of credit management, the view he has is of an advanced unit that few other businesses have. Whilst no longer working with full teams regionally, some activities – mainly collections – are retained locally to enable business hours to overlap. But most other functions such as credit analysis, reporting and vetting of letters of credit (LCs) have been brought into its global central Credit Business Service Centre located in Kuala Lumpur. With a head office team of just two (Vermylen and his deputy) maintaining global oversight and steering the course of credit management, the responsibility at the top reaches far beyond the traditional credit management remit into most other functions of the business.

"We have to understand the strategic agenda of each of the business units and get involved with projects early on because we are working almost like an internal banker, funding projects with BP's capital," he explains. It is, he adds, essential to understand this agenda from a credit point of view and consider how, with many of BP Petrochemicals' products being globally traded and subject to moving between regions, the precise nature of its customers' supply and demand shifts. "We have to understand the exact situation for each of our customers' plants, where they sit on the supply and demand curve, and whether they are considered to be first, second or third quartile because in the medium term this determines their prospect of survival." As an example of this, in Europe where many of BP's customers' plants were built between the 1960s and early 1990s, it is essential for Vermylen's team to know and to understand that the level of competition now coming from Asian plants in terms of increased scale, new technologies and wage arbitrage, cannot always be offset by the fact that product has to be shipped into Europe. It is this understanding, he says, that helps to drive good credit management.

A broad base

Grasping the intricacies of multiple business functions married to numerical analysis is something that comes naturally to Vermylen. He started his professional career in 1995 with Price Waterhouse (before it merged in 1997 with Coopers & Lybrand). From here he moved into banking securities, affording him a close-up view of how companies are funded. An interesting opportunity came up in 2002 in the form of a power trader in the Dutch market, where Vermylen was exposed to day-ahead positioning between the Leipzig and Amsterdam power markets, scheduling positions and matching. His employer was Enron. Having turned down an offer from Moody's, he took on the position with the BBB-rated Enron (as it was at that point). "Within a few months the company went belly-up!"

Following the excitement of the Enron-experience, Vermylen sought a more stable position. He found it as credit analyst for BP Chemicals Ltd, before the carve-out of mostly its polyolefins activity to Ineos, one of the biggest petrochemicals groups in Europe. For the next three years he had the largest credit analyst portfolio inside BP Chemicals, covering all Germanic speaking countries, Poland, the Czech Republic, Hungary and Slovakia. The call to his current position as Global Credit Manager within the BP Petrochemicals unit came in early 2005.

Although his cumulative experience and quest for stability led him to this senior financial role within one of the world's largest companies, Vermylen confesses that whilst the company has the image of an immovable monolith, "little did I know that oil and chemicals aren't actually by nature stable sectors. It may look from the outside quite stable – stagnant even – but inside it is on the move all the time, restructuring and adapting to the changing environment. If you like continuous progression and innovation, BP is a great place to be."

Making changes

It would be fair to assume that Vermylen's role has changed over the years and he explains that when he arrived a decade or so ago credit management was sometimes a bit too much of a "back office exercise", focused on filling in forms and offering advice "but often a bit too late". Under his guidance it has taken on a new dynamism that serves to provide solutions stemming from much closer integration of credit management with business and commercial lines. In the current Eurozone turmoil, his team started proactively looking for new markets and clients, where the capital tied up in BP's plants could be better used by moving as much volume away from the problem areas as possible.

The credit management team works with BP's treasury operation too. An area of particular attention is in cash forecasting, with credit providing timely data on days sales outstanding (DSO) and collections activities, as well as advising on specific client credit profiles. And although it is often considered the unique authority of treasury, he says credit management also helps in terms of managing and mitigating banking risk.

The global collapse of markets has naturally impacted on BP Petrochemicals' business, but in reality the effect has been slow moving and minimal compared to other sectors. "Looking back, I've noticed that the global financial crisis has had an impact on the collateral that we can accept in terms of LCs," notes Vermylen. "We've clamped down on bad banks as we improved the quality of the backers of LCs. The secondary effect of the crisis for us is that as some economies have been weakened we obviously have to move on and not rely on those that show obvious signs of distress."

Rather than run the risk of notching up bad debts, Vermylen put in place tighter credit policies – including revisiting credit terms, ceilings and ratings – back in 2008. "We set a new course, using closer monitoring of default-risk in our portfolio and so far we haven't been forced to update that policy."

Changing strategic course when it did, naturally had an impact on other functions within the business, treasury included. With a noted effect on DSO, the new credit regime clearly reaches directly into the cash forecasting process. But by moving away from distressed markets, product has to be shipped to new parts of the world where new payment methods may arise which, says Vermylen, "can put a lot of pressure on the lines we have with treasury from certain banks". In this respect he adds that there has been an increased level of interaction between the two functions.

This is something that has been seen in the collections process at BP Petrochemicals too. Vermylen describes it as already being "best in class" and this was further enhanced by closer integration with the company's commercial lines to bring a level of understanding that obviously pays dividends. With the credit team "upping its game a bit" in respect of collections, the need for rescheduling of debt has been limited.

The prudence of the credit manager is observable across many industries, notes Vermylen, adding that "everyone has been reacting in much the same way, getting more conservative". He feels that many of his peers have done a "tremendous job" in difficult circumstances and further declares that "now is a very good period to be a credit manager".

With a number of different elements to juggle, the aspect that takes up much of Vermylen's time in the current environment is the definition of a clear path in terms of capturing the most value for the business. He explains, "we have a number of higher risk customers. The easiest way to deal with them would be to decline credit, but in many cases this would automatically mean declining the sale as well. The trick is to be able to establish commercial relationships with these high risk counterparties that allow you to minimise any impact from a worsening financial standing at the right moment, if necessary. Getting that moment right is rather difficult but when you do it is most rewarding."

Allowing a couple of months more credit may mean a couple of million more in cash, or it may turn bad – judgement is everything. BP Petrochemicals will already have in place a LC where there is an established element of doubt concerning payment by the customer or about a sovereign risk. But it is the period before the credit team resorts to an LC, a guarantee or SWIFT's Bank Payment Obligation (BPO) that is the "interesting period that you need to get right and where a lot of value is created".

Stepping beyond tradition

The credit management department at BP Petrochemicals has travelled far. Under Vermylen's guidance, the team has been encouraged to head up to the frontline, to interact proactively with the customers, which has been found to get quicker results. It has also consciously upped the skills levels of its credit team, particularly in terms of their full and proper integration into the due diligence process and their involvement in, and exposure to, commercial contracts. This was something that had previously been handled only by the legal department but, as Vermylen notes, in terms of credit provision it could be very difficult for legal personnel to establish "what is appropriate, what is feasible and what makes sense". Added to this, with the benefit of Vermylen's own banking experience, the department was also able to put in place a number of credit trigger points, in much the same way that the ratings agencies operate.

Vermylen talks of a "very happy relationship" with BP Petrochemicals' numerous banking partners. Despite his favourable view, Vermylen does raise the issue of proprietary technologies that are often required to access bank services. Working with at least 50 banks globally he points out that this is "a lot of interaction". One potentially useful multi-bank foil to this nuisance is SWIFT's BPO. Working with its Oman-based client, Octal, and banking partner, Standard Chartered, BP Petrochemicals was one of the first corporates to use the BPO, adopting it in 1Q12.

Although the lack of widespread adoption of the BPO restricts its usefulness for now, Vermylen sees it as "a way forward" out of the multiple banking platform issue. He also argues for its capacity to add value to the trade risk mitigation process as its application can be delayed until the moment the bill of lading is secured from the freight forwarder; this gives an instant five to seven-day risk (and cost) advantage over an LC. Because it is an entirely electronic document, a BPO can also be set up at the point the goods are discharged at the port of arrival, affording it the functionality of a traditional 'documents against payment' arrangement. BP can instruct the presenting bank to hand over shipping and title documents to the customer only when that customer has paid in full.

Making IT work

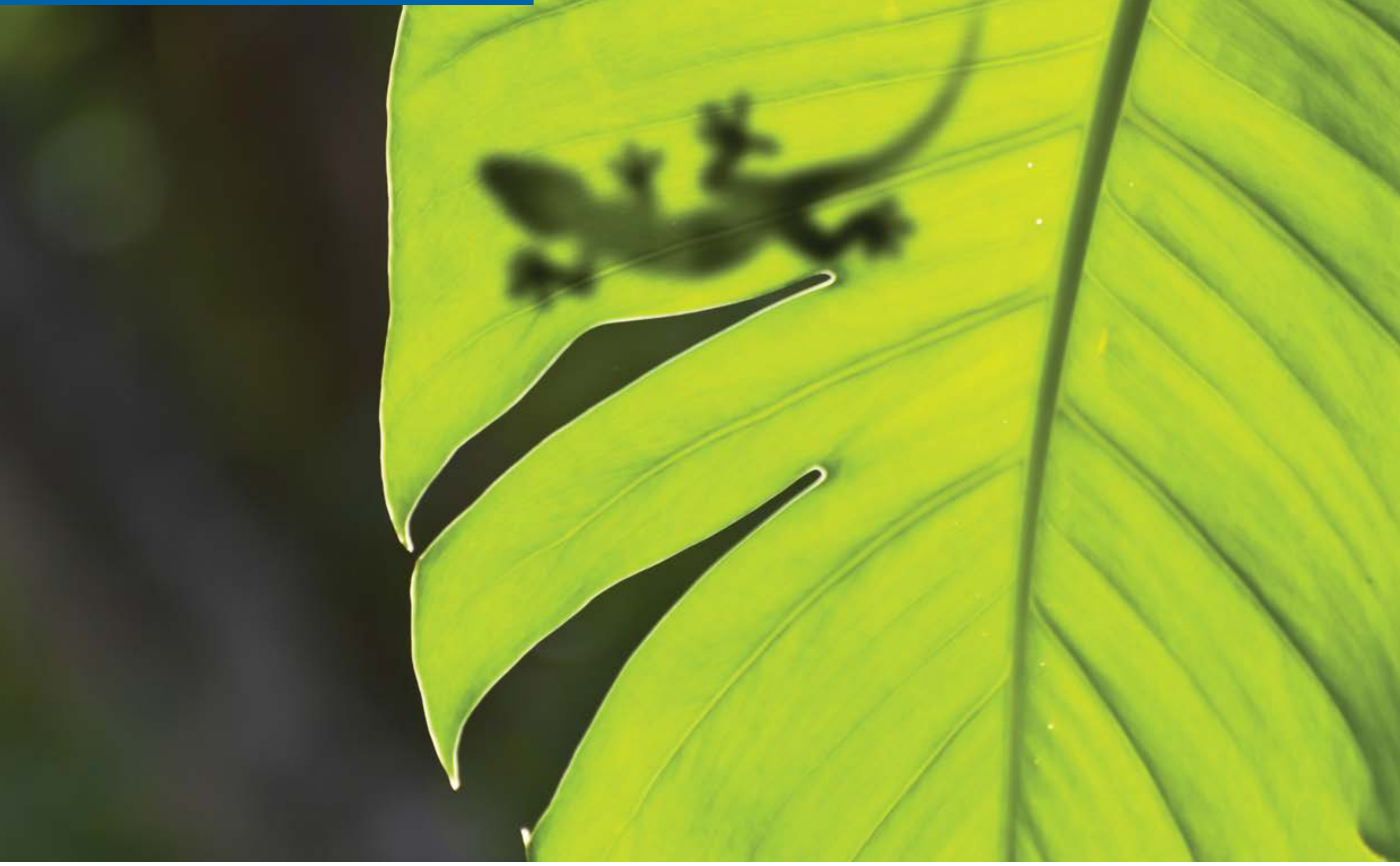
The BPO sits very much in the technology space and Vermylen acknowledges that IT is one of the last remaining areas within the credit department to undergo his full overhaul and modernisation programme. Having reviewed the existing IT toolkit, he felt that it was "lagging" and that the opportunity to improve efficiency had to be taken. These matters are currently being addressed by the company and as part of the project it is working with ELCY, a solution provider for the international trade finance community. The aim is to create a solution within the Asian service centre to handle incoming LC data across BP Petrochemicals, which may even serve as a bridgehead for an exercise of how the solution might work for the whole of the R&M segment. Vermylen explains that a process of IT modernisation in a large organisation such as BP can often take time to get underway because it is necessary first to review what other solutions may already be available within the business. If there is nothing suitable then agreement needs to be sought with other parts of the organisation regarding the best way forward, ensuring that one implementation can serve as many business units as possible.

Keep talking

In fact, he says that it is desirable to have that same degree of co-ordination and co-operation applied to the operational activities of the different functions within the company. Other functions that need operational credit department data often ask for it and it will typically be supplied on a spreadsheet. The advent of closer systems integration will facilitate automated enquires into areas such as banking lines or cash positions, greatly enhancing treasury operations, for example. Vermylen expresses his department's preference to be ahead of the curve when it comes to all the activities being undertaken by the business. Coming in at a late stage "when the horse has already bolted" is not ideal.

But as with most credit managers, the single aspect that most threatens to unsettle him is the potential for major loss. "Having credit losses is part of doing business; that is not the issue. But if you're in a position where you've lost a serious amount of money because you haven't properly put in place your controls and processes, that's like an own goal and does concern me."

But keeping ahead of the game is Vermylen's aim and being involved in elements such as working capital, and covering specific risks such as the Eurozone crisis, is where a global credit manager should be expanding the role, Vermylen says. With that in mind, the expectations of a dynamic company are well met by the broad expanse of his experience and knowledge. A credit to the industry indeed. ■



A hazy shade of banking

Just over four years ago, non-bank financial firms such as the Reserve Primary Fund were caught up in the storm wreaking havoc on the global financial markets. As a result the regulators are closing in. This article traces the reasons behind the rapid growth in shadow banking during the years leading up to the financial crisis, and then looks at the subsequent regulatory headwinds now shaping its future.

In the autumn of 2008, the banks at the heart of the Western financial system suffered a severe crisis, the likes of which had not been seen since the Great Depression. Governments around the world attempted to co-ordinate their efforts in introducing regulatory changes aimed at building a more stable, less leveraged global banking system.

Today, with banks having to scale back their risk taking activities in response to Basel III, attention is switching to the so-called shadow banking sector. In 2010, the G20 leaders gathered at the Seoul summit voiced their concerns about the role of shadow banking in the financial crisis and the Financial Stability Board (FSB) was asked to work with other international regulatory bodies in developing recommendations to strengthen oversight of the sector.

The functions performed by organisations outside of traditional banking – and, crucially, outside of the scope of banking regulation – have become increasingly important to the day-to-day operation of the global financial system over the course of the past decade. The Deloitte Shadow Banking Index published last year estimates that on the eve of the financial crisis, the total assets under management in the shadow banking system stood at over $20 trillion dollars, eclipsing even that of the traditional banking sector.

Since then, regulatory pressures have brought about a decline in the sector – in absolute terms and relative to the traditional banking sector. By 4Q11, assets were estimated at $9.53 trillion, more than 50% lower than at the 2008 peak (see Chart 1).

Despite this recent decline, introduction of the regulatory proposals currently being discussed will undoubtedly have a profound impact on the global economy. The credit intermediation, liquidity and maturity functions provided by shadow banking institutions are essential to many corporates.

Consequently, there is concern in the market that an overly stringent approach to regulation may damage the ability of non-banks to provide services upon which a large number of businesses still rely.

Blinded by the light

These concerns are particularly acute when it comes to the reform of the money market fund (MMF) industry. Tighter oversight of the industry has been on the agenda ever since the financial crisis, when the exposure to Lehman Brothers debt securities caused the Reserve Primary Fund to lower its share price below $1 and 'break the buck'. Other funds in the US and Europe were underwritten by their national governments. In the wake of those events, the Securities and Exchange Commission (SEC), who regulates financial markets in the US, adopted revisions to rule 2a7, requiring funds to improve liquidity and the credit quality of their portfolios.

> "SME treasurers are probably using CNAV MMFs because they are straightforward, easy to book and report on a tax basis. Now, if the market changes to a new way of doing things which requires you to change your accounting processes, then you may just think it is not worth the hassle and return to bank deposits."
>
> Aymeric Poizot, Head of EMEA Asset Manager Ratings team, Fitch

However, further reform of the industry is almost certain. One proposal, considered by the SEC and other international regulatory bodies such as the European Commission (EC), is to introduce a mandatory conversion to variable net asset value (VNAV). The backlash against constant NAV (CNAV) funds is based on the perception that investors will 'run' from a CNAV fund more readily as they aim to ensure they receive their full $1 per share value before the fund value fall below one and 'breaks the buck'. However this theory was not borne out by the behaviour witnessed in the crisis. Indeed many who did redeem shares from prime CNAV MMF promptly reinvested in government funds – which are also operated as CNAV.

But some opponents of this approach argue that a mandatory conversion to VNAV poses a serious threat to the MMF industry. A recent study found that of the investors surveyed, only 16% use VNAV funds alone. Meanwhile, a clear majority, 25% – equating to 50% of those who use MMFs – are said to prefer CNAV funds. Aymeric Poizot, Head of Fitch's EMEA Asset Manager Ratings team, says the survey revealed two commonly cited reasons for this apparent preference. Firstly, there is the inherent simplicity of the tax and accounting treatment required for users of CNAV funds; not every business will have the resources to cope with the added complexity a move to VNAV will bring, he asserts.

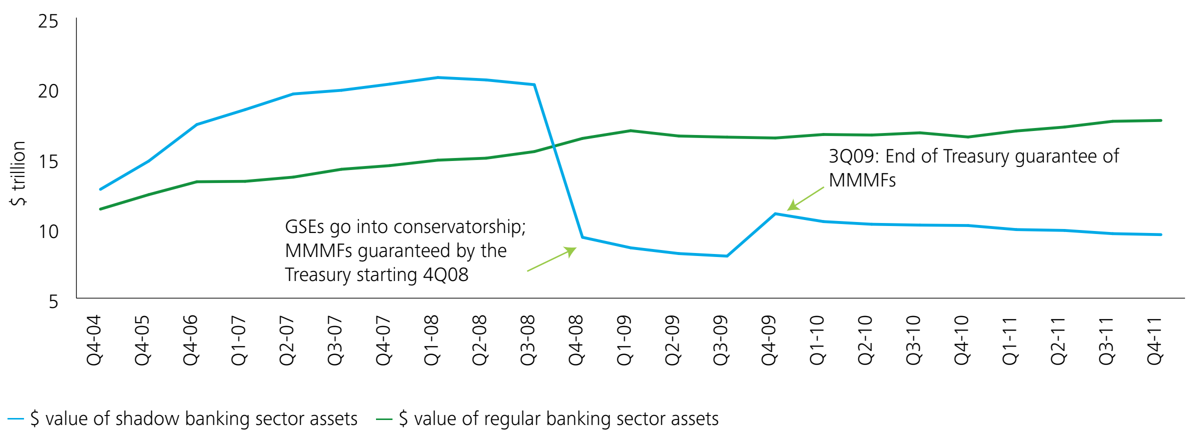
"If you are a treasurer for a small or medium-sized enterprise (SME), then this might cause a headache," he says. "They are probably using CNAV MMFs because they are straightforward, easy to book and report on a tax basis. Now, if the market changes to a new way of doing things which requires you to change your accounting processes, then you may think it is not worth the hassle and return to bank deposits."

Secondly, Poizot argues that a switch to VNAV may complicate risk management for corporates – something rather paradoxical, considering the overriding objective of the proposal is to reduce the level of risk in the market. "This is something the regulators do not appear to be fully aware of," he begins, explaining that when a treasurer uses a CNAV fund they are using a product with a very clear risk profile – the fund is rated by multiple agencies and has very strong governance. "But if all funds were to switch to VNAV, then there is a strong argument to be made that the risk profile of the industry would be less clearly defined."

If it's not broke…

Susan Hindle Barone, Secretary General of the Institutional Money Market Fund Association (IMMFA), is more cautious on the potential impact of a compulsory move to a floating NAV. "A lot of investors would be seriously inconvenienced if funds

Chart 1: Shadow banking versus traditional banking sector assets (US), 2004-2011



Source: SIFMA, Federal Reserve Bank of New York, Federal Reserve Flow of Funds, Haver Analytics and Data Explorers were forced to become VNAV. They really appreciate the simplicity of using a CNAV fund and the last thing we want to do is discourage them from achieving diversification in their cash holdings by pushing more of their money back into bank deposits," she says. However, if regulators persist and all the funds had to convert to floating NAVs, she believes that, given time and a pragmatic approach in tax and accounting treatment, many investors would transfer over to VNAV MMFs. The trouble is, she says, the premise that CNAV funds are inherently more risky is something the industry simply does not agree with.

> "VNAV does not tackle the fundamental reason why investors will redeem from an MMF, namely that they are concerned about the credit quality of a particular security in that fund."
>
> Joanna Cound, Head of Government Affairs and Public Policy, Europe at BlackRock

This argument is reinforced by a recent research paper published by the Columbia University School of Law, which studied the comparative run rate of the two types of MMF during what is now known colloquially as "Lehman week". The study found no empirical evidence to suggest that CNAV funds have a higher risk of "breaking the buck" in times of market stress. On the contrary, the two factors observed to contribute to run risk for MMFs were higher yields (indicating additional risk) and the perceived capacity of sponsors to support the fund.

It is the futility of the VNAV approach in terms of enhancing the stability of MMFs that concerns Hindle Barone most. "What worries us is that by switching the funds from CNAV to VNAV the regulators believe that with this they will be making a great contribution to global stability – a great step forward – yet we think that it will achieve nothing. It won't remove risk or interconnectedness from the market, and that is what really alarms us."

It is an argument echoed by Joanna Cound, Head of Government Affairs and Public Policy, Europe at BlackRock. Blackrock stresses that it is not opposed to either a conversion from CNAV to VNAV or to capital in principle but, like IMMFA, BlackRock does not believe the floating NAV proposal will be effective in addressing client redemptions in the event of a crisis. "It does not tackle the fundamental reason why investors will redeem from MMF, namely that they are concerned about the credit quality of a particular security in that fund. Clients ran during the 2007/ 2008 financial crisis because they didn't know which funds might be invested in Lehman Brothers or any other name in the headlines at that time. It was clearly a run to safety."

A similar argument is also made against capital buffers, another proposal currently being weighed up by European regulators. Having some capital put aside for times of market stress may make MMFs marginally more stable and better able to withstand idiosyncratic risk. "But such a level of capital will not be sufficient to protect a MMF facing mass client redemptions in the midst of a systemic crisis," according to Cound. "The amount of capital required to achieve this would be so large that it would make MMFs uneconomic for any fund manager to offer to their clients."

The alternatives

Both IMMFA and BlackRock are at pains to emphasise that they are not against regulation of MMFs per se; it is just that they do not agree on the efficacy of the above proposals. An alternative approach, one which the industry would almost certainly back, would be to introduce prescribed liquidity buffers. Unlike mandatory VNAV and capital buffers, a liquidity requirement would go right to the heart of the problem. When markets become stressed, as they did in 2008, the most effective protection for a fund is to have natural liquidity in its portfolio so that it can meet client redemptions without having to sell assets at low prices in a distressed market.

Another idea, currently being promoted by Blackrock, is to require fund managers to introduce redemption gates and liquidity fees which are activated when certain triggers are met. When the market enters a period of stress, an objective trigger is hit and the Board or Management Company would be obliged to gate the fund and reopen the next day with a liquidity fee. Clients who needed their cash would have access to it – providing they pay a small fee to ensure equal treatment of all the investors in a fund – but the overall volume of client redemptions would be reduced. "It would be the most effective means of mitigating a run on MMFs," Cound says. "Unlike mandatory conversation to VNAV and high levels of capital, which limit choice for investors, liquidity fees preserve the benefits of CNAV for those clients that require such MMFs, whilst effectively addressing the concerns of regulators."

End times for MMFs?

The regulators will certainly be aware of the concerns many in the MMF industry have over the current direction of reform. Yet a proposal drafted by the EC appears to indicate that the regulators are intent on pressing ahead, regardless of the opposition. The draft, which was leaked to the Financial Times in April, gives funds a choice of two options – either convert to a floating NAV or retain a 3% capital buffer.

If these proposals are introduced without amendments, corporate investors who maintain large cash balances in MMFs may well begin looking at the alternatives. For operational funds which require overnight liquidity, a return to bank deposits, even in the current ultra-low interest rate environment, seems to be the only feasible solution. But many companies are currently also holding onto funds as part of a longer-term cash reserve. For these funds, a short-term bond exchange traded fund (ETF) – such as the PIMCO Enhanced Short Maturity ETF – may be an option for consideration.

"There will be a solution," says Hindle Barone. "Like any equilibrium, it will find the right level. All we hope is that this is not to the detriment of investors because after all that's who the products are for." ■

The secret to EM success

In a recent 'Finger on the Pulse' poll on Treasury Today, the majority (61%) of respondents chose foreign exchange (FX) as their biggest cash and risk management when operating in emerging markets (EM), followed by cash flow forecasting and visibility and then regulatory complexity. Mark Tweedie, Head of Sales EMEA, Corporates, Treasury and Trade Solutions and Joakim Lidbark, Global Head CitiFX Corporate Solutions, Foreign Exchange, outline Citi's strategy for helping clients navigate liquidity management challenges in the EM.

Mark Tweedie

Joakim Lidbark

Around 70% of world growth over the next few years will come from emerging markets (EM), with China and India accounting for 40% of that growth. In 2005, less than 10% of the global Fortune 500 was headquartered in the emerging markets; last year, that proportion had grown to over 25%. Today multinational corporations (MNCs) are eagerly looking to enter or expand their business operations in these dynamic markets.

As the EM increases in importance within a corporate's overall growth strategy, treasurers are being called upon to improve visibility and control over the company's cash within these countries, which in turn is driving the desire for increased treasury centralisation. In order to use liquidity efficiently and rely less on external funding, a treasurer needs to know where the company's cash is, how much is in each locality and whether there are restrictions on its flows. However, this level of oversight can prove to be quite challenging. Given this importance, Citi has created an EM resource centre which is a single source of information on regulations required and its transactional services.

In addition, as corporates move from a distributor-led G3 currency (US dollar (USD), euro (EUR) and Japanese yen (JPY)) model to a full-fledged permanent local presence, they need to develop a strategy for modifying their working capital practices. Many of these companies are now looking to invoice in local currencies, as a result of becoming more responsive to the end customers' buying behaviour, funding currency and need to reduce FX volatility.

FX risk management

FX risk management in the EM is a hot topic, as shown by Treasury Today's 'Finger on the Pulse' poll. As a result many treasurers are looking to evolve their policies around currency hedging and the management of local currency positions. In doing so a common realisation is that existing G10 currency[1] hedging policies, which may be more than ten years old and written at a time when the corporate was G10-specific only, is not fit for purpose in the EM.

Depending on the sector, a typical corporate would use a hedging tenor of one to two years for its G10 FX exposures. However, as sales and revenue streams alike shift to EM, simply applying a G10 centric hedging policy may not suffice. This is mainly because of the cost of hedging EM currencies, but also in some circumstances due to liquidity and regulatory constraints. As a consequence, we believe that corporates with a global foot print should consider benefits of applying two separate approaches: one pursuing a long-term hedging policy in the G10 currencies; and the other with a much shorter hedging tenor, eg less than one year in the EM.

Before setting up a hedging policy, or rewriting one, corporates should first understand why they are hedging. For those corporates predominately managing G10 currencies, a common objective is to smooth out the peaks and troughs of year-on-year volatility. To achieve this goal, a corporate will need relatively long-term hedges in place such as provided by a layered hedging framework, where hedge ratios are built up gradually over time. However, in the EM smoothing volatility is not as straight forward due to factors such as the absence of mean-reversion, jump-risk and hedging cost; instead many use hedging as a means to lock in margins or achieve a budget rate over a specific period.

Citi helps corporates quantify risk, and then determines which types of derivatives can be used to mitigate the exposure. This advice is not limited to the type of derivative, but also to implementation method. Once a hedging policy is defined it's important to effectively track exposures and make sure it's accurately followed. For example, Citi's FX Pulse product allows subsidiaries to enter their exposures which feed up to central treasury in real time. Treasury can readily access a breakdown of cash flow and balance sheet exposures alongside their existing hedges, and in turn receive a clear instruction on how much more or less to hedge at any time to stay on target.

[1]G3 plus Canadian dollar (CAD), Australian dollar (AUD), New Zealand dollar (NZD), British pound (GBP), Swiss franc (CHF), Swedish krona (SEK) and Norwegian krone (NOK)

Luxottica Group S.p.A

Case study

Luxottica Group is a premium, luxury and sports eyewear company with manufacturing, retail and wholesale operations that span 130 countries worldwide. The company has adopted a regionalised treasury structure with each treasury centre responsible for cash and FX risk management in its own region.

In China, Luxottica has two manufacturing facilities plus retail and wholesale operations. The Chinese subsidiaries import and export raw materials and finished products to and from various group entities, the invoice currency primarily in USD, EUR and AUD. In addition, various group entities have trade flows with third-party suppliers in China where the invoice currency is in EUR or USD.

In 2010, the treasury team reviewed its FX flows worldwide with the objective of simplifying the invoicing process to minimise the FX risk in particular regions and concentrate it in Europe, where the company's main manufacturing facility and HQ are based, and its exports worldwide account for a significant percentage of the groups' FX exposure.

The internationalisation of the RMB was gaining momentum at the time so Luxottica assessed this in relation to flows with Chinese entities and decided that all inter-company flows with China would be re-invoiced in renminbi (RMB). As part of the review and transition to the new invoicing process, Luxottica mapped out all the relevant flows that would be affected by this change and worked with Citi on solutions to support the initiatives.

This involved its fiscal and tax departments, with a particular emphasis on transfer pricing; the IT department, charged with amending accounting systems and billing/logistics systems; and the treasury team, which co-ordinated with all relevant departments, including local finance teams. In the process, the treasury team in Europe opened a number of offshore RMB accounts with Citi to collect and pay RMB, and manage the FX risk using spot and forward deliverable RMB contracts. The whole project was completed in just six months.

Adopting the RMB has brought significant efficiencies to Luxottica: simplified invoicing for China and reduced currency pairs managed from AUD, EUR and USD to RMB; simplified hedging process, removing FX risk from China and concentrating FX risk in Europe; a greater natural hedge than it had before; lower transactional and operating costs.

With the increased liberalisation of the RMB, Luxottica is considering integrating the RMB into a global cash-pooling solution (such as multi-currency notional pooling) to concentrate its cash.

A netted risk view allows users to see total risk in a given currency pair, or indeed single currency, across all subsidiaries, exposures and value dates so that risk on aggregating positions across opposite functional and exposure currencies are quickly highlighted.

Cash management and cross-currency payments

As large multinational corporates (MNCs) move a greater proportion of their business and density of sales into the EM, they are looking at ways to repatriate surplus cash from financing and debt redemption. Corporates are increasingly using inter-company control, netting and sweeping (to the extent that currencies are fungible, or without capital or currency control restrictions).

Corporates need to stay abreast of new developments in global liquidity management, as the EM economies evolve. The most prominent example is the People's Bank of China (PBoC) and State Administration of Foreign Exchange's (SAFE) recent relaxation of RMB currency controls. Citi is participating in a pilot programme that includes just a handful of banks and corporates. In January, the bank completed its first cross-border lending transaction in RMB, conducted on behalf of a European consumer company. The money was lent to the company's regional treasury centre (RTC) in Singapore, in order to leverage its China operation's surplus cash and achieve greater efficiency in its global fund usage and allocation.

As they expand deeper into the EM, corporates are switching from foreign currency to local currency invoicing and searching for a single solution for cross-border payments. Citi's WorldLink product has continued to evolve for the past 30 years and now supports 2700 clients, processing 36 million payments per year. WorldLink is a multicurrency cross-border payments solution enabling clients to have a single funding currency while making payments in over 130 currencies.

Corporates, in particular those setting up joint ventures (JVs) to support their growth in EM, are using WorldLink as part of a 'banking lite' operating model and payment architecture. Common in the oil and gas industry, JVs are usually set up for finite timescales, such as for production and exploration projects. These JVs don't necessarily have the natural offset between accounts receivable (AR) and payable (AP), as crude oil is denominated in USD and shipped through commodity traders, whereas payments to tax authorities, suppliers, insurers, employees etc are in local currency. In this situation, often companies don't want to put a lot of expensive plumbing in place, or go down the laborious road of joint signing authorities, account openings and complex liquidity structures, with a new JV partner. Instead they want to fund the JV on an as-needed basis and make their proportionate share of disbursement from a treasury account.

As part of managing end-to-end financial flows, Citi supports corporates' employee expense management and business-to-business (B2B) purchase cards programmes. Companies usually want to drive more spend through cards to increase their control and leverage (from a procurement standpoint). Citi issues local currency commercial cards in over 65 countries, which means that the cardholder doesn't suffer from the local currency fluctuations and the corporate gets the benefit of the entire global spend, not just in the US and Western Europe where most issuers have acceptance capabilities. This holistic coverage means that procurement can negotiate with its suppliers based on the company's global spend and that card holders have a common experience irrespective of territory. To this end, Citi has become the only international bank offering this service in China.

Liquidity and trade finance

Operating in the EM raises corporate risk levels and many are looking to mitigate risk with early settlement of their pending receivables. Citi has focused its activity in the trade finance space to help clients with their payment terms to free up liquidity early on in the process. Citi also has a Global Concentration Engine providing treasurers with seamless end of day cash mobilisation for an unlimited number of accounts in 25 countries (the bank is currently expanding this), thereby minimising idle cash and consolidating cash in treasury hub locations.

Citi is active in the letters of credit (LC) space, which effectively swaps corporate risk for bank risk. LCs continue to be a common approach when companies enter into agreements with new trading counterparties. They are looking for a single counterparty to help them with their export LCs – not just issuing LCs but also discounting where possible to accelerate the cash conversion cycle.

Therefore, as clients go into new markets, trade services are a highly valued area of the corporate and bank partnership. Citi understands that having teams on the ground, illustratively, in Lagos, Nairobi, Algiers and Dubai is of critical importance especially when aligned to the largest correspondent bank network in the business. Citi has further invested in expanding and mobilising its electronic bank platforms to handle LC issuance and confirmations. Furthermore, the trade processing hubs at Citi are essential tools for the treasurer when navigating new markets.

In addition, and especially common in manufacturing and energy / refining industries, corporates are also looking for import loans and financing to buy equipment, which are most often large dollar-denominated purchases. By linking the asset to a trade transaction banks are able to reduce the risk capital intensity given the low loss given default rates and therefore price such loans attractively for corporates. Citi has further seen a significant expansion of interest in extending its successful supply chain finance programmes for clients to cover EM suppliers. Fundamentally, corporates need banking partners to help them navigate environments successfully and de-risk it. Citi, for example, was one of the first banks to set up LC re-issuances for the Trade Bank of Iraq (TBI), effectively swapping out exposure on Iraq for risk on Citi in UAE.

Wipro India

Case study

Wipro, a global IT company, has over 130,000 employees, with clients located in 54 countries. The company has established a shared service centre (SSC) in Bangalore, India, and embarked on a project to automate payments processing, migrating from the use of cheques to electronic payments (e-payments) for payments both in India and in Europe from its enterprise resource planning (ERP) system. This project proved highly successful, with a significant number of payments made electronically within the first year, leveraging uniform standards.

Since then, Wipro has extended the reach of its SSC across nearly 35 countries, and continued to pursue an active acquisition programme, further increasing the scale and complexity of the SSC's operations. Consequently, the company has worked closely with Citi to expand and enhance its activities to meet its changing business needs in 22 countries.

Wipro's SSC now makes payments on behalf of branches and subsidiaries in nearly 35 countries using a full range of payment methods to support the company's activities across eight countries in Central and Eastern Europe (CEE), Latin America and North America. When first establishing the SSC, Wipro used CitiDirect Online Banking for payments and account statements. More recently, the company has been working with Citi to migrate to a host-to-host connection with Wipro's ERP, enabling full straight through processing within a secure environment.

Wipro had already implemented Citi's Worldlink solution for making foreign currency payments from a single account. Most recently, the company has been expanded to the US for automating the production of cheques, and testing is in progress for the Canada region. In India, foreign currency payments can be complex because of the documentation requirements, which can make the process slow and labour-intensive. Wipro implemented Intralinks, which exchanges foreign currency payment information electronically with the bank, streamlining the process considerably, and ensuring that Wipro's team has to deal only with exceptions.

As a company with an ambitious growth strategy, Wipro has made frequent acquisitions in recent years. In order to achieve full visibility and control over cash, both for accounts held with Citi and third-party banks, Wipro chose Citi'sTreasuryVision programme, in order to give visibility over accounts globally. Around 60% of accounts are now accessible through TreasuryVision, which is also increasing rapidly, so Wipro will have full visibility over its cash balances globally, which can be extended to new accounts as the company structure continues to change and expand.

Panalpina Latin America

Case study

The Panalpina Group, a multi-modal transportation company, has global operations in more than 80 countries. In Colombia, the company faced unique challenges in its efforts to maximise cost efficiency and improve supplier relationships. Because ground transportation is particularly costly in the region with shippers demanding that all costs be paid up front, Panalpina Latin America focused on improving cash flow and meeting working capital goals.

In order to improve the company's working capital, it needed to renegotiate terms and conditions with ground transportation suppliers. With help from Citi the company implemented a supply chain finance (SCF) solution. After securing buy-in from the procurement team, treasury worked closely with the bank to put a customised Citi Supplier Finance programme in place. The programme offers suppliers the opportunity to turn their AR into immediate cash.

This innovative solution provides an electronic disbursement service with Citi acting as Panalpina Latin America's paying agent, allowing the bank to pay suppliers on their respective due dates. At the same time, Citi offers suppliers the option of accelerating AR payments, either through a true sale or a discount structure.

To initiate a payment, Panalpina Latin America informs Citi via electronic straight through processing (STP). Citi Supplier Finance presents these payments, along with underlying remittance information such as invoices or purchase orders, to the suppliers, who gain critical visibility into future payments. Suppliers may choose to elect early payment on all or some of these payments, or simply be paid at normal maturity. On the AR due date, Citi takes the collection directly from Panalpina Latin America through its debit authority.

The technology put in place by Panalpina Latin America and Citi has delivered a highly efficient host-to-host payment system that achieves low operative costs and reduced manpower requirements. While initially only implemented in Colombia, the corporate treasury team has to come to recognise the value of this structure for the entire organisation and has rolled it out across Latin America.

Further benefits of the SCF programme include supporting suppliers' working capital needs, which ensures continuity across supply chain sourcing. Suppliers' AR can be converted into cash more rapidly; and they gain better access to alternative financing options and highly competitive funding rates which reduce their financing costs. By unifying supplier payments through Citi, Panalpina Latin America is also able to achieve greater negotiation control.

For the company, working capital ratios have increased through improved days payable outstanding (DPO), days sales outstanding (DSO), and days inventory outstanding (DIO). By increasing the efficiency of its working capital flows, Panalpina Latin America was able to improve its financial indicators by more than 100% in less than one year, becoming one of the first divisions in the region to achieve this milestone.

De-risk, demystify and simplify

Citi's investment and commitment to the EM is absolutely core to its business strategy. Mike Corbat, Citigroup CEO, outlined the bank's orientation in his 1Q13 speech on 5th March: "For Citi, global doesn't mean packing up a suitcase and travelling to where a client needs to do a transaction. Global means we're established in the countries where our clients need us to do business, both in developed and emerging markets. They can make payroll in Tanzania. They can purchase raw materials in Indonesia. They can hedge currency risk in Korea. And they can do so knowing that they're dealing with a strong, well-regulated firm."

The bank has deep knowledge and experience in the EM, with MNCs as well as EM champions. This means it is well-positioned to comment on evolving trends, such as prudent treasury practices during the impact of the Arab Spring. Citi also enables corporates with centralised treasuries to be guided by the bank's relationship, sales and product teams as to what is happening from a regulatory change standpoint, whether that is Hungary's financial transaction tax (FTT) or new depositor insurance regulation in Kenya or Nigeria or the relaxation of RMB currency controls. The bank is effectively configured as an "early warning system" for its clients, with the aim of de-risking, demystifying and simplifying the EM.

MNCs are engaging in a significant amount of capital raising activity in the EM, as indeed are EM companies, given the attractiveness and the low spreads on the high yield debt and some of the EM debt. Clearly what the companies do with that cash once they have raised it and how they manage that cash is of principle concern for the group treasurer, who will be working hand-in-glove with the M&A department and the business development function. In addition, Citi is investing in banking evolution – CitiDirect BE – and has launched a mobile version of its CitiDirect platform, CitiDirect BE Mobile, with an upgraded user experience and new functionality, such as access to Trade Advisor. This enhancement, along with other channel extensions that Citi currently has in the works, is geared towards giving treasurers control and oversight of transactional activity across their business.

Corporate liquidity: the key to movement

In an environment where opportunities are beginning to open up, organisations – from sales managers to treasurers – have a renewed growth agenda, and are expanding where possible. Corporates are discovering that it's important to look internally to ensure operations are optimised and safeguarded – and well-positioned for achieving this growth.

Looking at liquidity requirements from a corporate perspective, there are several distinct elements, according to Ashutosh Kumar, Global Head of Corporate Cash and Trade, Transaction Banking, Standard Chartered. "Firstly, corporates simply need the liquidity for working capital purposes, so they go to a bank to borrow that liquidity. But the companies themselves generate liquidity in their day-to-day operations so they now want to look at how this can be used more efficiently. Furthermore, corporates are beginning to question why they actually need that amount of liquidity, trying to determine ways to reduce the liquidity requirement itself.

"There is a clear evolution there – treasurers are looking at all three aspects rather than just tapping the banking market for further liquidity. They are now having proactive conversations with their internal colleagues and banking partners to ensure that they have the appropriate liquidity profile in order to run their day-to-day operations."

Some corporates may also look towards alternative finance options such as the bond market. In 2012 corporate bond issuance exceeded loan issuance, and even those corporates who do not have access to capital markets are monitoring the growing trend. Marc Navalón, Group Treasury Manager at Ficosa International, says that although his biggest priority is the evolution of the loan market and getting the most out of the corporate banking relationship, "I keep an eye on the corporate bonds market because I think that our access to bank financing would become easier if big corporates and banks continue the issuance trend that we saw last year."

Making the capital work

Irrespective of anything else in the market at the moment, the biggest theme is that corporates are demanding much better control over their working capital, according to Raj Subramaniam, Head of Product Strategy and Marketing for Global CASHplus at Fundtech. "They see this as low hanging fruit and it is probably the first thing that they want to address in terms of improving their overall liquidity position."

When surplus cash is available to corporates, they are looking at investing this in primarily short-term instruments. Subramaniam says, "Corporates are still not looking for the highest yield and the treasury is still not seen as the profit centre of the company. We see many mergers and acquisitions (M&As) now as corporates feel that, rather than invest the funds in financial assets, it's better to invest it in new businesses."

Working in the manufacturing business for a firm that fully relies on bank financing, Navalón reports that in recent years Ficosa has increased cash balances to protect against the squeeze on loan growth. "In addition to that, we try to take a proactive approach to short-term cash management and aim to increase our visibility – and mobility – of cash worldwide as much as possible."

Ficosa has also placed a sharp focus on cash forecasting which it considers the core of corporate treasury and is extending its supply chain finance (SCF) products in order to reduce the cash consumption for working capital. "All these measures are helping us to sustain most of the financial needs of our businesses and are bringing cash awareness into the overall business," says Navalón.

For the corporate treasurer, Utopia is a state of negative working capital, believes Subramaniam. "They want to be in a situation where they don't need to put money aside for the working capital cycle as it is funded by their supply chain instead. Many corporates now see negative working capital as a way forward and are looking at the supply chain and the related available finance as ways for them to move towards that Nirvana state."

Financing solutions

Among the many things that corporates are aiming for in the quest for liquidity is to increase their days payable outstanding (DPO), meaning that they want to pay their suppliers later. This effectively means that the suppliers will have less liquidity, says Kumar. "In many cases, therefore, corporates are establishing strategic relationships with their suppliers and seeking SCF from their banks to establish better credit terms."

Different types of banks may show strength in different areas of SCF: multinational banks are very focused on vendor financing or supplier financing because the risk is mainly managed against the anchor corporate; while the strong domestic bank is very comfortable assessing the risk of, and providing financing to, dealers and distributors. Regardless of institution type, Subramaniam agrees that banks are offering SCF globally to strengthen and tighten the liquidity chain. "Banks are extending financing to the whole supply chain – not just to the main corporate but also to distributors, dealers and suppliers. This type of financial assistance is the quick win the corporates are looking for."

Many banks, even up to one or two years ago, were adjusting their liquidity solutions more towards the large or regional corporates, notes Subramaniam. But in the last 12 months, significant demand is also stemming from mid-sized corporates. "Corporates are pushing the banks to give them much better services regarding financial products around the supply chain. These services are linked to payment processing – the corporates want to get that process under tight control so that they can pay out at the very last moment and also pinpoint when they are in need of funds to cover a particular payment," he says.

Equally important is getting the receivables processing under control and corporates are moving away from paper and migrating towards more electronic ways of management in order to realise this. Subramaniam says, "many banks are looking at this space with interest and are actually outsourcing these facilities rather than putting the pressure on the corporates to make the change."

Global management

Many international corporates have hubs and factories in a number of different countries and regions, yet still want all their balances from various accounts to be immediately visible and easily swept and pooled. Naturally, this can prove to be very complex so they are first looking at liquidity management solutions which will help them define what kind of liquidity control they actually need to have. For example, if a corporate has offices in Belgium and the Netherlands which are primarily production sites (factories) but has customers located in France and Spain (offices), most of the offices will always have a cash surplus, while the factories will ordinarily retain cash deficit as they are making the payments for salaries etc. Subramaniam explains, "the corporates will want to manage liquidity that leaves a higher buffer in the factory location, ie €1m in each of the related accounts. But in the accounts that are customer-related and where money is coming in, this may be completely cancelled out. This kind of fine tuning is what treasuries are doing on a daily basis. Not only do the balances constantly change but the corporate's liquidity appetite will change too."

Firms are getting hungry and each treasurer still has to examine the environment and geography they are working in, what opportunities are available and whether the firm can take the counterparty risk involved. Monitoring counterparty risk has not been such a strong focus area for corporates, according to Subramaniam – even in the recent past. He maintains that it was an accepted practice that the transactions were all in the interest of doing business, yet "monitoring these risks across various types of counterparties – both banks and corporates – has now become a very visible activity. Corporates are looking at banks to help them with liquidity management across a country (or region) where they have accounts with multiple banks."

But despite enjoying a sense of cautious optimism and growth potential in 2013, the first year in several relatively unmarred by impending crisis, the package of capital and liquidity measures that constitutes Basel III still needs to be dealt with by the industry. Basically crafted to compensate for the pitfalls of the financial crisis, Kumar says, "this new regulation modified a one-dimensional Basel concerned with only risk capital to a three-dimensional regulation that covers risk capital, liquidity and leverage. The different requirements under the three areas have an impact on banks and corporates that are both intended and unintended."

Trade finance

One significant consequence of Basel III is the heavy burden attached to trade finance, so much so that it will become unattractive for banks to continue to offer these services to corporates, says Subramaniam. But with the relaxed deadlines, has the worry been postponed to a certain extent? "The banks and corporates are continuing to operate in a status quo mode. They have not changed their behaviour too much. They feel there is sufficient time for them to operate current business and still have time to think about what to do next when the deadline comes," he says.

Nevertheless, the strict measures are expected to deliver quite a blow to trade finance, which many corporates use for their imports and exports and their day-to-day working capital. A survey conducted by Asian Development Bank (ADB) in December 2012 revealed that if Basel was implemented as is currently stands, trade finance supply would reduce by around 13%. Kumar explains, "for different asset classes (mortgages/credit cards, etc), there are different risk curves on the basis of which banks would maintain capital. Yet, for trade finance, there is one risk curve which is applicable for trade and all other forms of corporate lending."

"Similarly with liquidity, there are both intended and unintended impacts. The measures state that banks should have liquid assets that can be used in times of stress – and these assets were defined as government bonds and certain other liquid assets. But the unintended impact was that not all countries/regions had enough available assets in which to invest."

Basel III implications

According to Arvind Ronad, Senior Executive Product Strategy and Marketing for Global CASHplus at Fundtech, the corporate treasury impact of the impending measures can be classified into different areas. "It involves more expensive bank funding as banks have to retain more capital to stay inside of their asset portfolio. Secondly, there are the casualties of trade finance as off balance sheet activity, such as the letter of guarantee, which requires five times more capital. The cost must be passed on in both of these cases."

Corporates will also be forced to rely heavily on the domestic debt market instead of raising funds in the cheaper market elsewhere, as accessing global markets and hedging through cross-currency swaps will be seriously curtailed due to credit value adjustment, says Ronad, "but there is an opportunity for the corporate to create a relationship with the bank because the Basel III liquidity standards will have a significant impact on how banks assess customer liquidity he added. Transaction banking, for example, holds more security as it gives stability to the corporate deposits – a win-win situation for both bank and corporate."

But the strain of meeting the Liquidity Coverage Ratio (LCR), the increasing amount and quality of bank capital, and pressure from local politicians to lend more to customers has led the banks to plead with the Basel Committee and local regulators for some reprieve. Dmitry Pugachevsky, Director of Research at Quantifi Solutions, says, "in January they received some relief, now that implementation of LCR is being phased in, starting with 60% of full requirement in 2015 and full implementation in 2019. Rules were also changed regarding what can be considered as high-quality liquid assets. Understandably, many local regulators didn't exactly welcome these changes in Basel III LCR treatment and warned banks who already comply at the 60% of full requirement not to decrease the level of high-liquidity assets."

From a corporate perspective, though, Navalón believes the decision to ease and to postpone the liquidity deadline for banks makes a lot of sense. "Four years ago we entered the 'new normal' era, whose fundamental forces are de-leveraging, de-globalisation and re-regulation. And it is the latter we are talking about here. Politicians risk over-reaction to their attempt at controlling the banks activities and this urge to regulate is causing a pro-cyclical effect on the credit channel and, therefore, in corporate access to liquidity. The postponement could be good for corporates if banks resume lending."

An expanding market

Another level of complexity to the whole liquidity situation is added by the fact that institutions in the US under Dodd-Frank have been mandated to start clearing swaps and other vanilla derivatives since March 2013, says Pugachevsky. "Initial and variation margins presented by central counterparties (CCPs) are putting another strain on banks' cash and high-quality assets reserves. How this situation will develop remains to be seen because it is just starting, but the fact that there is no cross-netting agreement between CCPs doesn't help."

As active as the regulatory space is, however, the corporate environment is continuing to evolve with an increasing drive for growth, says Kumar. Corporates are taking more counterparty risk – and country risk – but they want to manage this risk in a much more holistic manner. "Even in the open account scenario, which is picking up quite a bit in terms of a growing trend, you have a receivable financing product where the bank would take the risk of the buyers and finance the corporate, and so the risk is mitigated. Some corporates tap into the credit insurance market and buy insurance for their buyers and hence mitigate counterparty risk."

Credit insurance is very readily available in the West, but in emerging markets, the market for credit insurance may not be deep enough. However, SWIFT and ICC have jointly been working on the first end-to-end automated trade finance transaction – the Bank Payment Obligation (BPO). With an April 2013 approval scheduled, the BPO has already gained traction across Asia, providing customers with the flexibility of open account trade combined with the payment certainty of letters of credit (LCs).

Concluding on a positive note, Subramaniam believes that one common trend that can be seen among corporates is that the global worries about financial contagion have decreased considerably. "The panic which was there one or two years back has subsided. Risk is very much on the radar but it's not the only thing that people are looking at – they are also looking at opportunities," he says. ■

THE BANK INTERVIEW

Jim Fuell
Head of Global Liquidity for EMEA

J.P.Morgan
Asset Management

Jim Fuell, Managing Director, is the Head of Global Liquidity for Europe, Middle East and Africa (EMEA), overseeing sales and marketing for the liquidity business. An employee since 2006, he previously worked to develop the corporate business as part of the Global Liquidity team in London and has also worked for Deutsche Bank, Bank of Tokyo-Mitsubishi and Citibank. He holds an MBA in Finance and International Business from New York University, Stern School of Business, and a BS in Business Administration, Marketing & Finance from Marquette University.

The short-term investment market is in a state of flux as central banks and other national and international bodies seek to influence its direction. With cash-rich corporate investors looking for risk-appropriate opportunities to add yield, a bank needs scale, imagination and investment expertise in equal measures if it is to differentiate itself from the pack. Treasury Today talks to Jim Fuell, Head of Global Liquidity for EMEA, J.P. Morgan Asset Management, about what it takes to be a leader in this dynamic space.

What influences are having the greatest impact on the short-term investment market?

Actions by central banks have had a substantial impact on short-term investors. For corporate investors, the challenge increasingly relates to the management of the high levels of cash that many continue to carry, in an environment where returns on that cash continue to be relatively low. This increases their overall cost of carry.

These factors are driving the need for a manager who is prudent and looks for appropriate opportunities to add yield, while continuing to focus on the elements that remain critical to them – capital preservation, risk diversification and the availability of liquidity. The implications of aiming for additional investment income need to be extensively assessed, and we feel well positioned to work with investors in this regard.

So in meeting the needs of the short-term market, what do you feel are the key differentiators of a global leader?

A manager in a leadership position has to have true commitment to this business combined with the ability to take a long-term view. J.P. Morgan Asset Management (JPMAM) fits this profile. A number of the issues being faced right now by clients have been seen before, and our long history in this space gives us a perspective not held by many of our peers. Providing liquidity solutions are also a core business and primary focus for us — it is not simply a conduit for other parts of our asset management business.

Beyond this and underpinning everything that we do is our credit, risk management and investment expertise. We have a highly-resourced group of experienced credit analysts and portfolio managers spanning the world, and a global team of client advisors, which fully engage with our clients to ensure we are providing best-in-class solutions. Working together, the teams can deliver investment alternatives across a diverse array of currencies, strategies and jurisdictions, with the flexibility to also manage bespoke portfolios to suit a client's risk and return preferences.

How does the make-up of your team of credit analysts reflect these differentiators?

We have a total of 30 people driving our credit process, with an average of 12 years' experience with us and 16 years of industry experience. We have an extremely low turnover and there is a good reason for this: in a research-oriented organisation such as JPMAM, credit analysts have a highly valued role. They are career analysts specialising in short-term markets and that commitment is clearly exemplified by the experience they have within JPMAM and across this industry.

Is specialisation an important part of portfolio management and client servicing?

Very much so! We have portfolio management teams based in London, New York, São Paulo, Shanghai and Hong Kong, each with a level of specialisation helping them to understand the markets in which we are invested, and to offer clients the attention and advice they need. We also provide an integrated approach to client servicing, which is seen most clearly in the way we support our bespoke investment or separately managed account (SMA) relationships, with each new client assigned a client service team consisting of a client advisor, a client portfolio manager and a client service manager. I believe we offer an unrivalled level of expertise, which ultimately serves to underscore our focus and commitment to truly delivering liquidity solutions.

What about the client experience?

As a true global leader, we listen to clients and work with them to understand the specific challenges they face locally, and then work to develop solutions to mitigate these same challenges. In addition to specific client engagement plans, we hold annual client investment forums around the world. Events like these provide our investors with regular direct exposure to our portfolio management and credit and risk management teams. As a leader in this market, people also expect thought-leadership from us and to this end we have developed our Liquidity Insights series. As well as the global investment forums I just mentioned, the Liquidity Insights series also encompasses ad-hoc investor roundtables, focused client web-conferences and numerous topical white papers.

Why do your managers do the trading as well?

Our experienced managers are part of an investment desk strategy that sees the managers act as both portfolio managers and traders on our funds. This enables the managers to be fully apprised of all market developments as they happen, and at the same time be able to follow a streamlined decision making process with rapid execution in the market when opportunities arise. We see this alignment of the portfolio manager and trading roles as an important strength in the way we manage portfolios at J.P. Morgan. The systems used by the team are also specifically designed for money market portfolio management, decision making and trading. Our IT applications allow the portfolio managers to model quickly a trade in terms of tenor, dollar limits, percentage exposure and duration, and in turn make timely investment decisions within the fund.

How does your product portfolio meet the needs of investors?

The evolution of our product palette is aligned to the needs of our clients and is aimed at meeting and solving the challenges they face. On the short term side, we've grown from a core money market fund provider to a manager of a comprehensive series of short-term pooled investment fund solutions. Our product range includes both government and traditional credit-style money market funds alongside a product like our Managed Reserves Fund, which targets a level of return above that typically achieved by money market fund investors. Where some clients may wish to operate a customised portfolio, we have also continued to build out our ability to offer and support bespoke investment accounts. These enable a client to define specific parameters for security, returns and liquidity according to their own risk tolerance and cash flow needs.

Recently, the money fund industry has encountered some difficult markets and challenges never seen before – recent events in the Eurozone are a prime example of this, where actions by the central bank present a challenge for short-term managers and potentially for our underlying clients. For us, the key focus has been to create optionality for our clients, so that they have a range of solutions for the challenges they face. As an example, we were the first manager in Europe to launch a new type of share class – the Flex Dist. share class – in response to potential negative yields. In a positive environment it has similar characteristics to traditional distributing classes. If a negative yield environment prevails a mechanism can be applied to stabilise and maintain the Net Asset Value (NAV) per share at €1/$1/£1.

Alongside the product portfolio itself we have also maintained a focus on providing our investors with the tools and transparency to understand their investments. In this regard,

we were the first manager in Europe to disclose daily market-based NAVs per share for our core liquidity funds, giving investors further valuable insight into the funds in which they are invested. We also recently introduced a new enhancement to our online client trading platform, the Global Cash Portal (GCP). In addition to the GCP's existing features, which allow our clients to execute trades online and receive intraday trade notifications via email, we've also introduced a new portfolio analytics tool that allows investors to review the underlying investments within each of our funds in a more robust, dynamic way.

How do you approach credit and risk management? How can you be different?

In an environment where central bank rates are low across multiple currencies, it is arguably easier to see the distinction between ourselves and our peers. Sometimes there's an inference that all AAA rated funds are created equal, but they are not. Some of the differences reside in the manager's approach to credit risk management and appetite for risk.

Our Global Liquidity investment process is built on the following three core objectives:

- Preservation of principal.
- Maintaining adequate liquidity.
- Offering a competitive yield.

These are achieved through the combination of our dedicated portfolio implementation, world-class credit research and exceptional liquidity and risk management. Our credit research team evaluates credits within their particular sector and identifies investment opportunities by utilising a variety of information sources, including reports by the major rating agencies, fundamental data (including company financial statements) and external fixed income analysis reports. The team also extensively uses Bloomberg and the Citigroup Yield Book Analytics Programme, as well as several other specialised systems, to analyse securities. Analysts independently assess issuers, using both qualitative and quantitative inputs. Qualitative research involves evaluating each issuer's ability to avoid credit problems and event risks; assessing operating trends, cash flows, industry or product dominance and relative performance, compared with a peer group. For corporate credit, the key fundamental factors considered by the team include capital, asset quality, management, earnings, liquidity, industry and operating trends and alternative repayment options.

Client reporting is a key service requirement; what are you doing to meet client needs?

At a high level, we appreciate our clients' desire for greater transparency, and have evolved our business to meet that need. In addition to the disclosure of daily market-based NAVs, we also make our pooled-investment vehicle factsheets available more frequently and readily available via our dedicated global liquidity website, and our monthly client portfolio holding reports can now be received daily if required. Clients can also use the analytical tool within the GCP to analyse and dissect their data. All of this is aimed at giving clients an increased level of transparency around the investments that we are managing for them.

As a further measure, we have partnered with Clearwater Analytics to develop a web-based platform for reporting on the bespoke investment vehicles within SMAs. It's a user-friendly but comprehensive reporting tool that's ready for all constituencies including treasury, senior management, tax, audit, accounting and financial reporting to clients.

I believe these are all revolutionary steps in providing greater transparency to help investors make more informed decisions.

What should a client expect when establishing a bespoke investment account with JPMAM?

When establishing a bespoke investment account, our teams work closely with the client to set a clear mandate. The client service manager, working with our legal staff, will review and prepare an Investment Management Agreement, which outlines the responsibilities of JPMAM as a discretionary manager of the portfolio. The portfolio management team will hold detailed discussions with the client to establish the desired investment objective, benchmark, expected risk/return characteristics and other requirements of the new account. Based on these conversations, an investment strategy is developed, as well as a set of investment guidelines. These guidelines will be closely followed at all times so that the team can successfully execute the investment strategy on the client's behalf.

Are you really so different?

One of the things that clients really must consider when choosing an investment manager is the level of support and ongoing relationship management and client servicing each firm has the capacity to deliver. As a leading manager, we are constantly evolving. This is why we have the capabilities and product line-up to support client needs in a market that continues to present an increasing level of challenge. It's a commitment to the business which includes a level of resources that we don't see replicated by most of our peers.

We also lead from the front. Sometimes being a leader is not easy. Being first can present more challenges. But, we choose to set ourselves apart and responsibly anticipate the needs of the market place and regulators. For the client, this means we can continue to present them with the best options in the market. ■

Investing in the future

Sustainable and ethical investment instruments are not experiencing high demand from corporate treasurers, mainly due to a perceived trade-off between sustainability considerations and aspects that treasurers care most about: capital preservation, liquidity and yield.

In the 1700s, pharmacy group Alliance Boots took its social commitments seriously by providing cheap medicines for poor people. In 2013, the same social and ethical values are part of the company's DNA. "Corporate social responsibility (CSR) is so much easier if the values are incorporated into what people do," explains Richard Ellis, Director of CSR at Alliance Boots. "So whether you are a treasurer or a beautician working for Alliance Boots, we say incorporate these values into the way you do your job."

That may be easy for Ellis to say. After all, CSR is his sole remit and he works for a company with a strong ethical brand. But how and where does a corporate treasurer fit into all of this, if at all? Does environmental, social and governance (ESG) have any applicability to what they do? Even if they work for a company where ESG and CSR are core to its brand, how can a treasurer, who is typically focused on cash preservation and liquidity, incorporate sustainability and ethical considerations into their investment decisions?

Sustainable and ethical investments typically entail applying negative or positive screens to evaluate particular factors (tobacco, alcohol, weapons, etc), direct investments in renewables or carbon credits, investing in funds which contain issuers that are screened against ESG benchmarks, or ethical investments such as Islamic finance.

A number of EU corporate pension funds already integrate ESG into investment decisions, according to the European Sustainable Investment Forum (Eurosif). Eurosif's 2011 Corporate Pension Funds and Sustainable Investment Study found that 56% of surveyed corporate pension funds had a Socially Responsible Investment (SRI) policy in place, 60% consider that ESG factors affect a pension fund's long-term performance and 66% indicated that having an SRI policy is part of their fiduciary duty.

Pension funds, however, are typically long-term investors and are willing to tie their capital up for longer periods. Corporate treasurers, on the other hand, tend to take a more short-term view.

A short-term investment horizon

"Most corporates are in a net debt position so if they have got cash they tend to invest that in short-term bank deposits or money market funds (MMFs)," says Michael Wallis, Group Treasurer at Marks & Spencer. "That is more about securing cash and maintaining principal, whilst still getting some sort of return." Royston Da Costa, Group Assistant Treasurer, Treasury Systems and Development, Wolseley Group Services, states that Wolseley's policy regarding investing surplus cash is quite specific. "We either deposit short term with our relationship banks or use a select number of MMFs, based on their relationship with our banking partners," he explains.

In Europe, the uncertain economic outlook reinforces the need for treasurers to stay short when they are investing unless they are told otherwise, remarks Olivier Brissaud, former Managing Director of Volkswagen Group Services and Chairman of the Association des Trésoriers d'Entreprises en Belgique (ATEB). "In Europe at least, treasury is about making sure the company has – at any time – enough money to implement its business strategy. That by definition is a conservative investment profile," remarks Brissaud. "If the treasurer goes outside the traditional constraints provided for treasury and invests in ethical or sustainable investments they might lose money."

Finding out information about sustainable and ethical investments is also challenging for treasurers. "It is not that easy to find any ratings agencies that rate the ethical behaviour of companies," says Brissaud. For that reason ethical investments should be done through a company's CSR team, as they are responsible for (re)building a link between a company and society. François Masquelier, Chairman of the Association des Trésoriers d'Entreprise à Luxembourg (ATEL), says communication about potential ethical and sustainable investments is not great. "That can perhaps explain why ESG is not (yet) an issue for a vast majority of our members," he says.

Masquelier says treasurers are more focused on counterparty risk and on how to get decent (and if possible, not negative) returns. "The recent financial crisis has focused energies and priorities on other issues," he says. "Furthermore, even for longer-term investments, I am not convinced that CSR and ethics are top concerns. We should regret this but it is a fact. I'm convinced that things will evolve. Let's remain optimistic and see – often treasurers are followers."

Shareholders versus sustainability

In the case of longer-term investments, Jeff Wallace, Managing Partner at Greenwich Treasury Advisors, says companies with huge hoards of cash may be more likely to apply sustainable and ethical investment criteria. However, long-term corporate excess cash is mostly related to interest rate securities and very little equity, which is where most sustainable and ethical investments are made. When it comes to bond investments, Wallace says treasurers are paid not to lose money. "In fact they could lose their job if a bond investment went bad," he says.

Sometimes treasurers are involved in investment decisions made by the company pension scheme. Wallis of Marks & Spencer sits on the investment committee of the company's pension scheme. He is not directly involved in investment decisions but says the committee takes the ESG side of things very seriously. Marks & Spencer's pension scheme is a signatory to the UN's Principles for Responsible Investment (PRI).

> "It is not that easy to find any ratings agencies that rate the ethical behaviour of companies."
>
> Olivier Brissaud, former Managing Director of Volkswagen Group Services and Chairman of the Association des Trésoriers d'Entreprises en Belgique (ATEB)

Although treasurers concede they should perhaps look at other types of high yielding investments, including sustainable and ethical investments, Da Costa says they are still governed and guided by internal policies, which are set by the board, which in turn refers to its shareholders. While some shareholders are focused on short-term returns, others like private equity firms that invest for the longer term are insisting that companies pay closer attention to ESG. New York based private equity firm, KKR, which led a buy-out of Alliance Boots in 2007, believes ESG is essential when it comes to value protection (making sure a company it invests in doesn't lose money due to any ESG issues), value management (ensuring a company achieves best value) and value creation (integrating ESG into product sustainability to ensure operations run better).

Smarter investment decisions

Elizabeth Seeger, sustainability lead at KKR, says sustainable and ethical investment pays off in the short term, as well as the long term. In December 2012, KKR announced $365m in cost savings and revenue from its Green Portfolio Programme of companies by reducing greenhouse gas emissions, waste and use of water. "Environmental efficiency does have an impact on the financial performance of companies and on the bottom line in the short term," says Seeger. However, she says most people tend to think of ESG as being separate. "Part of the problem is the terminology – ESG, CSR, etc," she explains. "People fail to realise that just because you are thinking about cash flow doesn't mean you are not thinking about ESG issues."

This raises a number of important questions for treasurers. Treasurers manage cash flows, but what about the quality and sustainability of those flows? "We have a tendency to think about economic systems as though participants only need to worry about the micro issues which affect them, and everything else will fix itself," observes David Pitt-Watson, a Senior Fund Manager and Treasurer at UK charity Oxfam. Although corporate treasurers may think their actions will have very little impact, Pitt-Watson says they should take a step back, look at what they are doing and how it fits with things happening in the rest of the world. What can they do to make sure they are supporting responsible investment? How can they modify their actions whether working on their own or with others?

But does ESG mean sacrificing capital preservation, liquidity and yield – aspects treasurers most care about when making investments? "In the minority of cases, you may have to sacrifice profitability," says Pitt-Watson, "but once ESG is integrated into your system it becomes less costly and often profitable. If everyone focuses on sustainability issues, we will all be much better off."

Keith Welks, Deputy State Treasurer for Pennsylvania, says many asset owners have become accustomed to entreaties for investments that are sustainable but are not good investments from a principal preservation and yield perspective. "As a result, some of them run for the hills if they get a whiff of ESG, even if the opportunity might otherwise still be appropriate for them. I believe you can make these kinds of investments work in many instances. You need to think about the structure that works for you as an investor with multiple objectives and look at opportunities with open eyes."

Much like a corporate treasury, Pennsylvania State Treasury has a prudent investor obligation, which means it must invest in a manner that preserves principal, maximises liquidity and generates returns or yield. In 2005 a new State Treasurer was appointed in Pennsylvania, and Welks and other members of the treasury team were asked to consider a fourth factor when making investments – an added benefit to the state's economy, a particular segment of the population or an appropriate public policy objective.

"That is when we started looking at the energy efficiency of residential homes that would cost owners less," says Welks. Treasury set up an investment scheme for homeowners offering them low-rate loans (11,000 loans worth $80m) for energy efficiency measures. It recently aggregated a large number of the loans and sold them in the secondary market. The loan portfolio generated a yield of 5%. "It has outperformed fixed income investments," says Welks, "generating appropriate and acceptable returns with limited risk, which gives us the opportunity to make funding available to 11,000 homes."

Pennsylvania State Treasury also developed an investment fund where it provides 20% equity for making energy conservation improvements to old college buildings. By focusing on proven technologies and also providing a steady stream of income, Welks says the college fund addresses two of the most common objections to clean energy: it avoids technology risk and provides liquidity much earlier in the investment cycle.

Where it uses external investment managers, treasury also started asking them about their sustainability criteria – employment of women and ethnic minorities, environmental and sustainable practices both by the managers and the investments they review. "We've gotten pretty anodyne responses to our inquiries so far," says Welks. "Right now we're at the stage of deciding how we apply the information that we have. We still expect a good rate of return from our investments with these managers but we are also looking for double or triple line benefits. As prudent investors we try to figure out what are the attributes we should be looking for in order to make smarter investment decisions that make money for treasury."

MMFs with a conscience

Fund provider Amundi in France has made it easier for corporate treasurers to gain investment exposure to ESG without really having to do anything. It applies SRI criteria to its flagship MMF, Amundi Treso EONIA ISR, which has €25 billion in assets under management. Amundi's SRI filter is applied to all issuers in the fund and its team of SRI analysts do all the groundwork in terms of assessing the SRI credentials of issuers.

"We are providing customers with additional analysis, which adds value," says Patrick Simeon, Head of MMFs at Amundi, adding that most of the French corporate treasurers that invest in its SRI MMF have responded with interest. Assets under management in the Treso EONIA ISR fund have increased by 25% since 2011. In terms of the fund's performance, in this asset class Simeon says the main issue is that the investment universe is over weighted towards banking and financial names with an average SRI ranking. "This doesn't weigh much on the performance of the MMF," he explains. "It is purely adding transparency. The key element of our approach is security and liquidity. Performance is the cherry on top of the cake."

Dominique Blanc, Head of SRI Research at Novethic, a leading CSR and SRI research centre in France, says there are significant assets in SRI MMFs in France. According to its research, in 2012 the French SRI market saw growth of 39%, following a growth of 69% in 2011. Although corporate investors are not necessarily asking for SRI, Blanc says they are not saying no to it either. "The financial and risk characteristics of these funds are the same as traditional MMFs, but as a value add they have a sustainability aspect," he explains. A breakdown of SRI assets by type of owner shows that in 2012 corporates made up 6%, the fifth largest group behind insurers, pension funds and public funds.

Sustainable bonds

Another asset class that presents corporate treasurers with SRI opportunities are sustainability bonds. Last year, FMO, the Dutch development bank in the Netherlands, issued a $41.3m six-year sustainability bond for KLM Royal Dutch Airlines. Treasury and Risk Manager, Vijay Panday, made the investment on KLM's behalf. "KLM is pleased to participate in the sustainable bond issued by FMO," he stated. "This combines our financial strategy to further reduce our US dollar currency risk and our strategy to be leading the industry regarding sustainability." KLM is a signatory to the UN Global Impact initiative of 1999. It also occupies the sector leadership position in the Dow Jones Sustainability Index.

"More and more investors are attaching a value to the non-financial aspects but it's still not mainstream," remarks Huib-Jan de Ruijter, Director of Financial Markets for FMO. The sustainability bond developed for KLM was the first issued by the development bank, which uses negative screens to exclude certain companies, and also applies environmental and social requirements such as the IFC Performance Standards on Environmental and Social Sustainability to all its financing activities. The cash flow of the bonds are not directly linked to the credit risk of a specific project and FMO has a AAA credit rating. "The bond matched the needs of KLM's treasury and it can be tailored in terms of tenor and currency," de Ruijter explains. He says treasurers should look at sustainability bonds in the same way as they look at other investments, but the extra bonus is the non-financial component. "I am not suggesting that they should get more on the non-financial side and give up something on the financial side. They don't need to make that trade off." ■

INSIGHT AND ANALYSIS

Will cash ever die?

Physically moving cash around is costly and inefficient, as many corporates still use armoured cars to pick up cash from numerous locations. The dream of a cashless society has been discussed for decades – but how close is the reality? What are the main barriers to doing away with cash?

THE BIGGER PICTURE

Milton Friedman

The 20th Century's most prominent advocate of free markets, American economist Milton Friedman is known for his research on consumption analysis, monetary history and theory, and the complexity of stabilisation policy. His monetary theory influenced the Federal Reserve's response to the 2007–2012 global financial crisis.

TECHNOLOGY

FX portals

Foreign exchange (FX) portals promise to simplify the process of trading currencies, with quick and easy processes in place. Despite slow uptake, portal providers are striving to stay ahead of the development curve. What new technologies are on offer today?

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

Andrew Bailey (AMCT, MSTA), National Grid Money Markets Team; **Susan Hindle Barone**, Secretary General of the Institutional Money Market Fund Association (IMMFA); **Carole Berndt**, Head of GTS for EMEA, Bank of America Merrill Lynch (BofA Merrill); **Dominique Blanc**, Head of SRI Research, Novethic; **Olivier Brissaud**, former Managing Director of Volkswagen Group Services and Chairman of the Association des Trésoriers d'Entreprises en Belgique (ATEB); **Jonathan Chesebrough**, Head of Risk Advisory, Royal Bank of Scotland (RBS); **Joanna Cound**, Head of Government Affairs and Public Policy, Europe, BlackRock; **Ellen Cornelissen**, Director Treasury Europe, Aleris Switzerland; **Royston Da Costa**, Group Assistant Treasurer, Treasury Systems and Development, Wolseley Group Services; **Sue Dean**, Managing Director and Head of Transaction Services EMEA, J.P. Morgan; **Rohan Douglas**, CEO, Quantifi Solutions; **Richard Ellis**, Director of CSR, Alliance Boots; **Richard Jaggard**, Managing Director and Head of Transaction Banking Europe, Standard Chartered; **Tamer Karabulut**, Head of Treasury Operations, Türk Telekom; **Ashutosh Kumar**, Global Head of Corporate Cash and Trade, Transaction Banking, Standard Chartered; **François Masquelier**, Chairman of the Association des Trésoriers d'Entreprise à Luxembourg (ATEL); **Marc Navalón**, Group Treasury Manager at Ficosa International; **Vijay Panday**, Treasury and Risk Manager, KLM Royal Dutch Airlines; **David Pitt-Watson**, Senior Fund Manager and Treasurer, Oxfam; **Aymeric Poizot**, Head of EMEA Asset Manager Ratings, Fitch; **Dmitry Pugachevsky**, Director of Research, Quantifi Solutions; **Diane S. Reyes**, Global Head of Payments and Cash Management, HSBC ; **Arvind Ronad**, Senior Executive Product Strategy and Marketing for Global CASHplus, Fundtech; **Huib-Jan de Ruijter**, Director of Financial Markets, FMO; **Sameer Sawhney**, Global Head of Transaction Banking, ANZ; **Elizabeth Seeger**, Sustainability Lead, KKR; **Patrick Simeon**, Head of MMFs, Amundi; **Raj Subramaniam**, Head of Product Strategy and Marketing for Global CASHplus, Fundtech; **Tim Thompson**, Senior Manager, Enterprise and Risk Services, Deloitte; **David Vermylen**, Global Credit Manager, BP Petrochemicals; **Jeff Wallace**, Managing Partner, Greenwich Treasury Advisors; **Michael Wallis**, Group Treasurer, Marks & Spencer; **Keith Welks**, Deputy State Treasurer for Pennsylvania.

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