treasury today

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October 2013

Benchmarking for excellence

One thing is clear, there is no 'one size fits all' approach to treasury benchmarking. However, despite complications, measuring performance against best-in-class can reap significant benefits.

Women in Treasury

Maeve C. Robinson

Assistant Treasurer

Omnicom Group

The Corporate View

Stuart Kirk

Director of Global FX Risk Management

Xerox

New regulations

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Doing the right thing

Ethics in the workplace

Cash management

Avoiding the cash trap

Back to basics

IAS 39 in hindsight

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CONTACT US

New York
708 Third Avenue, 15th Floor
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London
Moor House, 1st Floor
120 London Wall
London EC2Y 5ET
+44 (0) 203 580 6100

Singapore
1 Raffles Place
#52-00 One Raffles Place
Singapore, 048616
+65 6309 1000

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Website Assistant
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Managing Director
Richard Parkinson

Switchboard	+44 (0)13 0462 9000
Publisher	+44 (0)13 0462 9012
Subscriptions	+44 (0)13 0462 9002
Advertising	+44 (0)13 0462 9018
Editorial	+44 (0)13 0462 9004
Production	+44 (0)13 0462 9013
Fax	+44 (0)13 0462 9010

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Will MMFs make it over the regulatory hurdle?

The battle over new money market fund (MMF) regulations is coming to a head on both sides of the Atlantic. Early last month the European Commission (EC) put forward its proposals as to how to ensure the stability of the MMF industry and the money markets as a whole whilst, in the US, the three-month consultation regarding the US Securities and Exchange Commission's (SEC) proposals saw a flurry of comments before it closed for consultation on 17th September.

The main point of contention in both sets of proposals is the major restrictions proposed for constant net asset value (CNAV) funds and the encouragement regulators are giving to managers converting to variable net asset value (VNAV) MMFs. Most market participants believe it will be to the detriment of investors, issuers and the economy as a whole. The SEC directly proposes MMFs to move to VNAV or continue as CNAV with the use of liquidity gates and fees. The EC proposal, on the other hand, calls for CNAV funds to have a 'capital buffer' of 3% which, argues its opponents, is uneconomic for an asset manager to hold in a MMF.

However, even the use of liquidity gates and fees if a fund's liquidity level falls below a specified threshold is not finding favour in the US. In his comment published on the SEC website, Gregg Murphey, Manager Global Treasury, Novelis Inc., argues that this proposal will "bring into question one of the greatest strengths of a prime MMF – liquidity".

In addition, given the SEC's decision to reject the use of capital buffers for US MMFs, the Institutional Money Market Fund Association (IMMFA) believes that there is now a "serious risk that cross-border arbitrage opportunities will be created". However our analysis is that the opportunity for arbitrage is limited by tax and other regulatory issues.

Secretary General of IMMFA, Susan Hindle Barone, has issued a call to action for all market participants to "make their voices heard, whichever avenue that takes". But it may be too late.

To help corporate treasurers navigate the complexities of new MMF regulations, Treasury Today is publishing a special article on the subject in this issue.

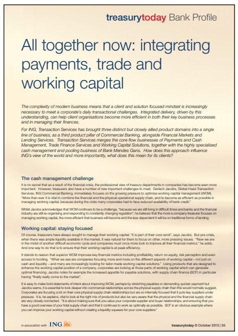
Come and see us if you are in Barcelona

Last month we were at Sibos in Dubai with the banking community. This month we will be attending the International EuroFinance Conference in Barcelona with more than 1500 delegates from the corporate community. Please feel free to drop by our stand (L01) and meet the team on the conference floor.

IN THIS ISSUE

The art of benchmarking

While the corporate treasurer is garnering more Board attention as a consequence of the financial crisis, they are increasingly looking to quantify how well they are performing in their roles compared with their peers. The first step is determining whether you are benchmarking the right things.



treasurytoday Bank Profile

All together now: integrating payments, trade and working capital

in association with ING

Smarter Treasury

Coping with low rates and changes in the money markets

in association with HSBC Global Asset Management

Maeve C. Robinson
Assistant Treasurer
Omnicom Group Inc.

Winner of the first-ever Treasury Today Woman of the Year Award at this year's Adam Smith Awards, Maeve Robinson says that her favourite part of the job is discovering ways to make treasury more efficient, looking for "the next big idea" to streamline processes.

Whither go European MMFs?

On 4th September, the European Commission (EC) released its long-awaited proposals for increasing money market fund (MMF) regulation. What effect will these proposals have on the industry and choices for short-term investment instruments?

treasurytoday Talking Treasury Forum

Global Cash Management

Global Cash Management

With a still-challenging global economic environment, corporates are firmly focused on cash visibility and access. Are corporates finding it easier to attain the desired level of cash visibility, or is there something they need to do in order to get to the next level? How can banks help their clients navigate these challenges and, importantly, are they living up to the corporates' expectations?

Key trends in cash and trade

Anand Pande, Global Head of Trade, and Steve Everett, Global Head of Cash Management at RBS, look at some of the major trends affecting the transaction banking space.

in association with RBS

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Escaping the cash trap

Despite an increased level of regulation across the world, there is also a degree of liberalisation happening, particularly in the historically restrictive Asian markets. But the challenge now is for corporate treasurers to be able to navigate these rapidly changing regulatory environments.

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The only way is ethics

Operating 'for the greater good' is often seen as laudable, but 'good' is notoriously difficult to define. However, such considerations can have a positive effect not only on employee morale and community standing, but also the bottom line of the company – clearly 'doing the right thing' is not just a cost.

TREASURY ESSENTIALS

39 The Corporate View

Stuart Kirk
Director of Global FX Risk Management

xerox

Stuart Kirk attributes his disciplined methodological approach to his Yellow Belt for Lean Six Sigma business processes. His quest for clarity and order saw Kirk collecting the Best Foreign Exchange Solution at Treasury Today's Adam Smith Awards 2013.

BUSINESS BRIEFING

Managing liquidity through periods of rising interest rates

As the outlook for economic growth in the developed world has improved, investors are increasingly focusing on how much longer central banks will keep interest rates at record lows and when they will change the trajectory of their asset-purchase programmes.

in association with J.P.Morgan Asset Management

These pages contain edited versions of a few of the Treasury Insight pieces written in the last month. The full versions are posted on treasurytoday.com as they are ready. The Treasury Insights weekly email summarises the new pieces from that week plus other news relevant to treasury. You can register for this free service at treasurytoday.com

Bolero: dancing to a different tune

Bolero is one of those financial solutions, like TWIST, that has been in the corporate space for many years and yet has never really taken off, despite the promise of good things. Named after a moderately slow tempo Latin dance, it certainly has taken its time to build support. This may be about to change. For a start, corporate uptake in the past nine months has doubled to almost 70. This sudden burst of interest is worthy of attention in itself, but the platform now has three of the big four Chinese banks on board, a vote of confidence which could open up electronic trade presentation in Asian markets.

Bolero's software-as-a-service (SaaS) delivery model provides trade solutions for large corporates (including many large-scale bulk commodities sellers and some very large multinational traders such as Siemens, Nokia, Glencore and ABB) in two key areas: multi-banking trade finance applications and electronic trade documentation. The idea in the first instance is to provide a single platform multi-bank electronic trade finance management tool for traditional trade instruments such as letters of credit (LCs), bank guarantees and presentations. But Bolero also aims to dematerialise trade documentation, enabling end-to-end flow for trade under LC, open account and the ICC/SWIFT Bank Payment Obligation (BPO).

Time is money

All high value cross-border transactions, regardless of the settlement instrument, have a requirement to place in the hands of the buyer as soon as possible, the original trade documentation. Most notable is the bill of lading, which evidences receipt of goods for shipment, their delivery and legal title, without which banks will not release payment.

Whilst the bank data matching element of the BPO is a major advance, it too is driven by the speed at which paper-based shipping documentation physically moves along the chain. The UK arm of the global shipping industry's carrier insurance scheme, run through P&I (protection and indemnity) clubs, acknowledges that "non-availability, or non-production, of a bill of lading is becoming more common". Delays can be costly for all parties not least the shipping company which has to decide what to do with the goods as it waits in port.

The missing links for high value cross-border LC, BPO or open account trade, says Bolero's Vice President of Product Strategy, Tom Rahder, are the electronic bill of lading and the ability not just to notify but also to present on the LC electronically. These are now part of the Bolero offering and the P&I clubs have given their approval because, as Rahder points out, an encrypted, digitally signed document is more secure, quicker and easier to deliver than its paper equivalent.

BPO: SWIFT's viewpoint in Dubai

The main themes of Sibos, SWIFT's user conference, were around the changing global dynamics, regulatory reform and operational excellence. But it was the BPO that stole the stage, whether inside or outside the main conference agenda. Maybe that is because it encompasses all three themes: it is proving to be much more popular in the still vibrant Asia region; it may help to mitigate some of the risk surrounding regulatory reforms; and it should make the lives of corporates that much easier through greater efficiency in trade. Or maybe it is because SWIFT decided to make a big push this year to ramp up adoption.

To date there are just six banks live on BPO, and these are all Asia-based. Six more banks are ready to go live, and 53 banking groups are said to be adopting BPO. Conversations with a number of banks on the conference floor has indicated a lack of demand for, or understanding of, BPO. Without corporate customers clamouring for this tool, the banks are hesitant to put much effort into rolling it out; however, that leaves the industry waiting for a groundswell of first movers to really push it forward.

This is the reason why SWIFT has gone on an educational offensive, as much for the banking community's benefit as for the corporates. But BPO is caught between the proverbial rock and a hard place: for corporates, it is a tool that could take away the pain of letters of credit (LCs); whereas the banks, who benefit from LC fees, would prefer to see it replace open account transactions – which accounts for 85% of global trade yet is a space where the banks have no role to play. SWIFT is trying to position it in the middle, claiming that there will be a coexistence of LCs, BPO and open account.

At a Barclays breakfast briefing, 'BPO: reshaping global trade', Andre Casterman, Global Head of Corporate and Supply Chain Markets, SWIFT, was clear that BPO was not a product in itself, but a tool that products can be built upon. "BPO is a decision between two corporates, similar to the LC world. Bankers need to build a commercial value proposition around this tool." He argued that BPO allows supply chain finance (SCF) to start when it should, ie pre-shipment financing and purchase order services.

Interestingly, in a session entitled 'Exploring the evolution of SCF', which is part of the dedicated Corporate Forum stream, Gary Slawther, Treasurer at Octal Petrochemicals, was vocal in his support for BPO. "I like BPO for it provides a level of liberation. The main benefit is that it puts the power into the treasurer's hands. With this new tool, I no longer have to negotiate with the banks." He believes that as soon as there is a critical mass of corporates using BPO, then everyone will follow.

Controversially Slawther went as far as to say that the LC is "dead", effectively arguing that it is possible to take LCs out of the picture, as they only provide "a bank account and credit". However, the LC death toll has been heard many times in the past and yet they continue to be an important risk mitigation tool.

Junkyard challenge

"The salad days for junk debt are at an end," declares Tom Byrne, Director of Fixed Income for US-based wealth planners, Wealth Strategies and Management (and author of the daily Bond Squad market report). Byrne's view has for some time been that pumping money into the high yield/junk bond (grade BB or below) corporate sector has a limited life, and that doing so has only served to shore up corporates with weak balance sheets and questionable business models. But as the markets start to move a little, he urges investors to pause for thought: "Winter is coming for junk debt; consider seeking shelter now, if you have not already done so."

According to an article in the Wall Street Journal, cited by Byrne, some experts have been saying that "de-leveraging is over and re-leveraging is well under way", as corporate borrowers take new loans "hand over fist from investors hungry for higher returns". The FT supports its observations with a quote from Christina Padgett, Head of Leveraged Finance Research at Moody's Investors Service, who notes: "Leverage is getting back to where it was pre-crisis."

Indeed, Bond Squad has reported on a number of companies issuing bonds and stock to pay off loans "only to take out more loans, leaving the new bonds and diluted stock outstanding". In recent times, investors have been only too keen to scoop up corporate loan securities offered by their investment companies on the promise of higher yields and relatively low default rates which, Byrne points out with some bemusement, have been based on historical models. "But here is the truth, folks: corporate defaults have plummeted because corporations which could have/should have defaulted have been kept alive by leverage provided by yield-hungry investors."

That quest for yield was partly a Federal Reserve design, explains Byrne. Its low-rate policy was put in place as a way of encouraging investors to provide capital to businesses, especially those offering attractive rates. "But as yields fell throughout the credit markets, investors reached deeper and deeper into junk." What's more, the readiness of investors to get into junk saw many companies seeing a quick fix and taking on too much debt in a market that seemingly had cash to spare.

Continue at your own risk

But Byrne believes that a "great re-normalisation" of monetary policy and interest rates is due. "And interest rate normalisation probably means corporate default normalisation," he adds. "That leaves debt – both loans and bonds – issued by junk-rated companies at an increased risk of default." As yield-hunters find satisfaction in higher-rated investments, many of the lower-grade businesses may suddenly face difficulties in obtaining credit, if they can get it at all. "Believe the pie-in-the-sky stories of high yield, manageable risk and a decoupling with rates at your own risk," he warns.

Do you have a plan B for SEPA?

The golden rule in any project design is to always have a plan B. It's becoming clear, however, that there is no fall-back plan for the Single Euro Payments Area (SEPA), despite all indications that many corporates will not be ready in time.

One in three companies is still at risk of not being ready for the upcoming Single Euro Payments Area (SEPA) deadline of 1st February 2014, according to a PwC report, 'SEPA Readiness Thermometer August 2013 update – Prepare a plan B'. A survey of 150 companies about their state of readiness indicates that companies have underestimated the effort required to comply, and few of them have a backup plan should they fail to be ready in time.

"If every third company were unable to instruct its bank to settle its obligations, this would be alarming news to all," explains Bas Rebel, Senior Director Treasury advisory at PwC in the Netherlands. "This goes beyond reputational damage to the individual company; it may create a backlog in repairs at banks and liquidity problems for beneficiaries."

Prepare your backup plan

In the eventuality that they are not ready, less than half (46%) of the respondents admit to not having thought about a backup plan, with 16% relying on assistance from their bank. Hardly any respondents have implemented or tested a backup plan.

"The 34% of companies at high risk of not meeting the deadline should now seriously consider a backup plan," says Rebel. "But they should understand that a backup plan cannot be implemented overnight. It needs preparation and does not necessarily provide a shortcut for all aspects of 'plan A'." In its report, PwC makes a number of recommendations for those corporates preparing their plan B. ■

Longer versions of these articles are available at treasurytoday.com/treasury-insights

This much I know

Maeve C. Robinson

Assistant Treasurer

OmnicomGroup

What is your career-defining moment?

I am always looking for new challenges and opportunities to grow. In 1994, when I was eight months pregnant, I changed jobs, moving from public accounting into treasury. It wasn't easy but it certainly was a defining moment in my career. I realised that I could do anything, even starting a new job and giving birth in the same month. It certainly impressed my colleagues and hopefully inspired a few women along the way.

Which women in business most inspire you and why?

One of my bosses in public accounting would sign everything she did in very neat penmanship. She always said that you should sign your work with your full name because you should be proud of what you have accomplished. I try to apply her philosophy to everything that I do.

What is the biggest challenge you are facing just now?

The global financial environment becomes more complicated every day, so my challenge is to make sure we have a solid foundation in place to keep Omnicom going day-to-day and years into the future, without any hiccups.

What couldn't you manage without?

My talented and highly motivated staff. If it wasn't for their contributions, I wouldn't be here today. They are a loyal, hardworking group. I would also add my babysitter, who has been the backbone of my family.

What is your next major objective?

We are working on a project that is likely to be a game-changer in payments. It will save Omnicom several million dollars a year in banking fees, make the company much more efficient, and provide increased visibility on our spending. This should be up and running in Canada and the US within a year.

What advice would you give to other women in treasury?

Use your creativity. Sometimes women have a different perspective which can be helpful during a brain-storming, problem-solving session. Don't be afraid to be creative and thoughtful, nor to speak out, even when you are outnumbered. If you do it the right way, it will get the reception that it deserves.

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

When I first went into public accounting, I was disappointed not to gain experience at a financial institution. Rather, the only opportunity I was offered was in the advertising industry. But if I had worked in a bank, who knows where I would be today. I couldn't be happier than working at Omnicom.

"Don't be afraid to be creative and thoughtful, nor to speak out, even when you are outnumbered."

ON THE WEB

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

Winning the first-ever Treasury Today Woman of the Year Award at the 2013 Adam Smith Awards came as a shock to Maeve Robinson, for she hadn't been aware that her team had nominated her. "I only discovered that they had nominated me when notified that I had won the award. I was so thrilled. And the best part of winning was that my staff thought enough of me to put my name in the hat," she says. "Omnicom wouldn't be where it is today without my great staff, so I think of it as a 'team of the year' award."

Reading her case study clearly demonstrates the reasons why our judges honoured her, with 19.5 years of dedication inside the company, as well as outside the company in the wider community. A Certified Public Accountant (CPA), Robinson holds a number of other titles within Omnicom, including Treasurer of Omnicom Capital Inc. (OCI) and CFO of Omnicom Finance Canada, as well as having other global responsibilities. She is a founding principal of 'Omnicom Cares', her company's community service initiative which organises projects in support of children worldwide.

Interestingly, as a result of her experience winning the Woman of the Year award, Robinson has recognised that developing women's networks are very important and now plans to look into doing something at Omnicom. "I am thinking small at first, maybe just something in our building here in Connecticut, and then perhaps broaden out to New York City.

"Currently, we do not have a formal mentoring policy at Omnicom, although I think of it as part of my job to develop everyone who works for me. I don't treat the men or women that work for me any differently, but sometimes I feel that women need a different type of mentoring than men, so I try to fulfil that requirement."

On the job

Robinson began her career in accounting, spending ten years in public accounting at Coopers & Lybrand. She was fast-tracked to management, first to manager in three and half years and then on the partner path, but decided that she didn't want to go on to be a partner. Through her public accounting experience she became a specialist in advertising agencies, effectively becoming the "go-to person" for any advertising-related questions.

When a good friend landed the job as controller at Omnicom, "which was my dream job" she says, he called Robinson a year or so later to see if she was interested in a career change out of public accounting and into treasury. "And thankfully, one thing led to another and that brought me over to Omnicom and my career in treasury – and I haven't looked back," she says.

Today, Robinson manages the US, Canadian and the Latin American treasury operations. The company's global treasury structure is centralised within regional treasury centres (RTCs) acting as in-house banks (IHBs). Globally, the local offices conduct their own banking procedures but their account balance is reduced to zero at the end of the day and transferred to their designated RTC. The liquidity from each RTC can then be opportunistically invested locally or concentrated at the Connecticut treasury centre, headquarters for the corporation's treasury. Robinson manages the company's daily liquidity positioning.

The current market environment is creating a number of challenges for Robinson, as with the vast majority of other treasurers. "Liquidity is always an issue. Currently, we fund ourselves daily with commercial paper – it is inexpensive and a very liquid market at present. But that could dry up tomorrow and then what would we do? My job is to ensure that we have a structure in place to keep us going day-to-day in spite of challenging market conditions."

In addition to banking and liquidity, treasury at Omnicom is responsible for working capital management, with Robinson managing the working capital programmes in the regions she oversees. "We work with all the operations in those regions to improve their cash management activities, including billing and collection practices, processing of vendor invoices, etc, in order to improve our working capital. This was a big part of my job when I first arrived, as accounting makes up a large part of working capital – for example understanding how the billing process works. This was an easy conversion to make because of my public accounting background."

Her favourite part of the job is discovering ways to make treasury more efficient, looking for "the next big idea" to streamline processes by, for example, implementing a new system. Since Robinson joined the company in 1994, the organisation has grown seven-fold and treasury staff has only increased by between five and ten people. "As a result of putting in new systems and automating processes, there is less manual intervention and manual error, which ultimately means less risk for treasury," she says. ■

Maeve C. Robinson is currently Assistant Treasurer of Omnicom Group Inc. and the Treasurer of its wholly owned subsidiary Omnicom Capital Inc. She is responsible for all treasury operations in North America, as well as providing direction for treasury processes and systems across Omnicom's global footprint. Additionally, Robinson plays a lead role in Omnicom's credit risk management, credit insurance programmes, working capital programme, and treasury accounting and systems. Giving back to local communities has always been important to Robinson and she put her passion to work by becoming a founding principal of Omnicom Cares, the group's community service initiative which organises community projects in support of children worldwide. Prior to joining Omnicom in 1994, Robinson was a Senior Manager at Coopers & Lybrand (now PwC), working primarily in the advertising and marketing sectors. She has more than two decades of accounting, finance, working capital and cash management experience. She received her BBA from Siena College and is a CPA.

Overcoming COBO challenges

Tapping our collective knowledge to get better information

What are the main obstacles in setting up a collections-on-behalf-of structure (COBO) and how have corporates overcome these issues?

Martin Schlageter, Head of Treasury Operations, Roche:

At Roche, we had already established an in-house bank (IHB) and centralised our treasury operations for many years, so developing a collections-on-behalf-of (COBO) structure was the next logical step. When we were setting up our COBO in assorted countries, it was very helpful that subsidiaries were already used to working with the IHB and therefore had trust in our services. They needed confidence that we can collect customer payments at least as well as they can, and that we run reliable and robust IHB-processes.

In regards to COBO, the key point is fast and automated reconciliation of accounts receivable (AR). If a company runs one central euro account for many countries, in order to reconcile payments it has to be able to identify which customer is paying which subsidiary.

Thanks to Deutsche Bank, we were able to put in place a virtual account structure that ultimately feeds all euro-payments into our central euro account. With this solution, each customer makes payments using a unique International Bank Account Number (IBAN), allowing Roche to identify which customer is paying which entity. For us, this was the vital component to establishing a reliable COBO structure. In the meantime, this solution won this year's Treasury Today Adam Smith Award for the Best AP/AR Solution.

We did encounter some local obstacles to setting up a COBO structure. For example, the Federation of Finnish Financial Services (FFFS) defines standards to optimise payments between corporates and banks, including a barcode system for invoices, allowing the customer to make an automated payment. But this barcode system only works with a Finnish IBAN. As a result, we are not able to reroute the collections of one of our Finnish entities to our central euro account outside Finland. It is an obstacle which conflicts with the concept of the Single Euro Payments Area (SEPA) – which is supposed to harmonise the payments environment in the euro area – and one which we are currently engaging with the regulators in order to overcome.

Basak Toprak, Director, Citi Treasury and Trade Solutions:

The main challenges around COBO structures are similar to those that corporates face with POBO. Having said that more corporates have established POBO structures to date. The main reason for this is the fact that corporates have advanced quicker in centralising payments versus collections. Collections are generally handled by local businesses, where the knowledge of customer relationships exist. Companies have now started looking at how to further benefit from their shared service centres (SSCs) by centralising their receivables processes, and COBO is a natural part of this evolution.

In a COBO structure, the agent (usually the IHB entity) collects the assets belonging to other entities. A COBO set-up helps to achieve not only bank account reductions but facilitates centralisation of reconciliation activities and can lead to better credit management. There are several structural considerations related to COBO set-ups, which can be grouped into four themes:

1. **Legal, regulatory and tax considerations**: It is important for the corporate to find out whether the participating entities are allowed to operate under a COBO model, and what if any are the reporting or central bank approval requirements. In some countries in Asia or CIS, for example, the regulators simply do not permit COBO.
2. **Accounting**: Companies who set up POBO/COBO structures do so in an IHB environment. The IHB act as a single entity under which all the business units perform their financial transactions. POBO/COBO structures result in inter-company loans, so these need to be accounted for in an IHB structure.
3. **Reconciliation**: Automatically identifying who has paid for what invoice is a challenging area for corporates even without a COBO structure. With a COBO structure, you have the added complexity of receiving funds into a single account and therefore you rely on the sender to include details as to which entity they are paying to. Banks and technology companies can provide solutions to support this process in the way of reconciliation tools, such as data enrichment and matching services, as well as virtual accounts, where each debtor is given a unique account number into which they make their payment. Furthermore, SEPA introduces Ultimate Creditor (UC) and Ultimate Debtor (UD) fields which support POBO/COBO payments.
4. **Technology**: Companies who embark upon setting up POBO/COBO structures typically have a single instance ERP environment, which helps to support inter-company reconciliation, as well as real-time updating of assets and liabilities based on payment information.

The migration to SEPA in particular has increased the number of companies exploring COBO. However, to date live implemented examples of COBO are very limited. We expect that once companies meet the migration requirements of SEPA, they will look at leveraging SEPA to introduce further efficiencies to their working capital management structure. At that point, COBO will be a key topic.

Ad Van der Poel, Head of Payments and Receivables, EMEA, Global Transaction Services, Bank of America Merrill Lynch:

Corporates will likely encounter a number of obstacles when attempting to set up a COBO structure. Firstly, receivables have always been local processes and, as a result, corporates will still have to implement different receivables instruments in different jurisdictions, which would reduce the benefits that could be gained by centralising them.

With the arrival of SEPA, however, this is now changing. With SEPA Direct Debit (SDD) for example, in principle there is one standardised receivables instrument across the Eurozone. So as a result, more companies are beginning to explore the COBO concept.

A second obstacle is the resistance that is often encountered within an organisation. Local sales entities, which are focused on revenues, will often resist because they want to retain some form of control over their revenues through receivables. Therefore, in my opinion, an internal education process needs to happen. It is for that reason that COBO has not developed as fast as payments-on-behalf-of (POBO).

Thirdly, the big incentives for centralising receivables are efficiency improvements, better rates and improved reconciliation. But many of these benefits take time to realise, whereas some businesses want the benefits to materialise immediately. To get it right companies need to fine-tune the process and establish the structure step-by-step.

When companies overcome these obstacles they may encounter more practical difficulties. A company that is introducing a COBO structure will have to consider how they are going to do mandates-on-behalf-of and what the language requirements will entail. As a corporate, it might be easier for mandates to be in one language, such as English. However, there may be regulations that require it to be in the local language. This is just one of many practical issues which may arise once a company begins attempting to implement a COBO structure. ■

The next question:

"How much of treasury can be outsourced? What pitfalls are common and how can a treasurer get around them?"

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

Is Citi right or wrong about Asia's economic growth potential?

Citi's CEO for Asia Pacific, Stephen Bird, has predicted meteoric economic growth for both China and India, to become the largest and third largest economies by 2030. However, there are many challenges that still need to be overcome for this prediction to become a reality, not least intraregional tensions between nations.

The rate at which the US is recovering from recession is the slowest since World War II. Meanwhile, the Eurozone and the UK have not yet recovered the economic losses of the past years; the Eurozone is creeping out of recession at a snail's pace. In Latin America, growth has slowed. In addition, whereas some African economies are growing fast, in economic terms the continent is far too small to lead the way for the global economy.

Theoretically, Asia could act as an economic catalyst. Its population represents 27% of the total world economy. To quote Stephen Bird, CEO for Citi in Asia Pacific: "By the middle of this century we expect Asia to account for close to half of the world's gross domestic product (GDP). By 2030, we are forecasting China and India to be the largest and third-largest economies in the world."

Citi's Bird bases his optimistic view on the economic fundamentals. Investors are also looking at the political situation in the region, and the individual countries, and are less sanguine in their outlook.

Explosive region

Thirty years ago, China's economy was smaller than the economy of the Netherlands. Now it is the second-largest economy on the planet, behind the US. Japan occupies the third place.

As Kevin Rudd – the former Prime Minister of Australia – wrote in Foreign Affairs: "History teaches that where economic power goes, political and strategic power usually follows." Increasingly, China is positioning itself as a superpower; 'great power politics' is the order of the day in Asia. Political (and often economic) developments are strongly influenced by a raft of sub-regional conflicts and contentious issues.

Asian states are not only worried by China. Many have unresolved issues with Japan that are rooted in recent history. Some believe Prime Minister Shinzō Abe to be jingoist and are afraid that he will rewrite Japan's pacifist constitution, under which the country is only allowed defensive military capabilities.

With an ever more assertive China, nerves in Japan, the strategic involvement of the US, and a raft of smaller countries that need to protect their interests in this geopolitical cauldron – it is clear that stability is not guaranteed.

Chinese-Japanese enmity

First, what do its neighbours think of Beijing's attitude? Nine out of ten Japanese and Koreans take a negative view of the ascent of China, and so do more than 70% of Australians and two-thirds of Filipinos.

In recent years Beijing has appeared more willing to enter into confrontation. Its military spending increases year-on-year – by more than 10% in 2013 – and the Chinese are busy constructing their first indigenous aircraft carrier. On hearing the news, many regional leaders may have felt shivers running down their spines. Particularly in Japan, even if Tokyo is also making waves with a new military vessel – its largest since World War II. Ominously, it is named after a Japanese cruiser that was used during the invasion of China in the early 20th century.

In recent years, there have been many news articles about tensions over the disputed Diaoyu aka Senkaku islands. At the same time, large-scale protests erupted in China and Japan. Chinese rulers started to refer to the islands as "China's core interest", thereby placing them in the same category as Taiwan and Tibet.

The political fallout was just the half of it. Chinese riots and protests caused $120m worth of damage to Japanese companies in China, and Japanese auto exports to China dropped by approximately 40-50% as a result of a boycott.

Will they or won't they?

Not surprisingly, surveys show more than 90% of the Chinese dislike Japan, while 90% of Japanese respondents have an unfavourable impression of China. The thorniest issues are territorial conflicts and unhealed World War II wounds.

Some experts think military budgets of both Japan and China give cause for concern. In the past 23 years, China's (official) defence budget has increased thirty-fold, while Japan's military spending has risen for the first time in 11 years. The billion-dollar question is whether there is a real chance that the two countries will lock horns.

The high degree of Chinese-Japanese economic interdependence suggests a large-scale trade war is improbable, while many experts contend that real armed conflict is very unlikely. Not least because the global economy is linked to the Chinese and Japanese economies in myriad ways. This was evident, for example, when Apple suffered product shortages in the aftermath of Japan's triple disaster in 2011. These days, numerous production chains are global and a country like the US has every reason to go out of its way to prevent escalating Sino-Japanese tensions.

Domestic preventive factors

Other factors also indicate that an outright (trade) war between Japan and China does not loom large. China has so many internal problems such as pollution, corruption, protests, inequality and food security that it can do without squabbles with its neighbours. Before it can afford to take a more assertive stance on the global stage, China needs to tackle some of these obstacles, which are impeding political, economic and social progress.

Japan, too, struggles with various domestic issues: excessively high farming subsidies and an overly powerful agriculture lobby; overregulation; a low participation of women in the economic process; an immigration policy that needs to be reformed; rigid job markets. Prime Minister Abe must know that Japan's geopolitical standing will deteriorate unless it enacts structural reforms.

Also relevant is that Japan is not automatically inclined to impose its ideology on the world, unlike many Western countries, including the US with its Manifest Destiny in the 19th century or the attempts to export democracy under George W. Bush. Mostly, Japan has been exclusively interested in its own survival.

Irrational war could still happen

Counter to these arguments – which suggest that geopolitical fireworks are unlikely – other developments could give investors pause for thought. Research into wars that occurred during the past few centuries shows that many wars break out for emotive reasons. Often, economic standing was the dominant motive; revenge frequently played a part.

World War I, a major disaster, showed that nationalist sentiments can be stronger than economic self-interest and rational financial arguments, a matter of heart over mind, even in the highest political circles.

In addition, nations regularly underestimate the costs of war. The Americans, for example, were too optimistic about the efforts and funds needed to win the wars in Korea, Vietnam, Afghanistan and the second Gulf War in Iraq. Should Japan or China too fail to look realistically at the outcome of a potential armed conflict, they will more easily engage in war.

Equally, China could misread the US security commitment to Japan. Richard K. Betts of the Council on Foreign Relations says that the US sends ambiguous signals to Beijing. It is unclear whether the US sees China as a "threat to be contained or power to be accommodated. US policy amounts to a yellow light. Yellow lights, however, tempt some drivers to speed up."

Misunderstandings, miscalculations, insecurity, jingoism, and populism can combine into a dangerous cocktail, causing escalations that nobody actually wants and that make little economic sense.

Will Asia deviate from the historical norm?

Antagonism between Japan and China is but one of the possible geopolitical dangers in the Far East. Tensions are rife between North and South Korea, and also between Cambodia and Thailand. In these cases too, a level-headed economic analysis would conclude there is no risk of escalation. Yet, smooth relationships are never a given in a shifting political landscape. To quote Prime Minister Rudd again: "History teaches that the rise of new great powers often triggers major global conflict."

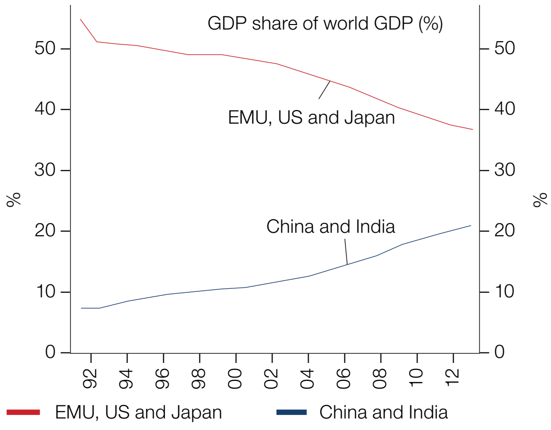
Stability is precarious. Little wonder that the Asian markets have disappointed Citi's CEO Bird and many others. China and Japan are not expected to unleash tanks, warplanes, and cannons in the immediate future. However, constant geopolitical tension may well distract politicians to such an extent that they fail to implement domestic economic reforms.

Meanwhile, the existing cross-border suspicions, rampant insecurity and raw nerves are not conducive to economic partnerships and integration. On top of this, there are plenty of economic factors that can fuel tensions in the region.

One example is yen weakness. A substantial depreciation of the Japanese currency was an important element of the Asia crisis at the end of the 1990s. In recent quarters, policymakers in the countries neighbouring Japan may well have watched with growing unease as the yen continued to fall.

As ever the region provides many challenges and it will be interesting to see if Bird's predictions are right. ■

Chart 1: Will Asia continue to rise?



Source: Thomson Reuters Datastream/ECR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The art of benchmarking

There is an adage in business circles that what cannot be measured cannot be managed. By benchmarking, treasury professionals can measure their performance against their peers and implement improvements if necessary. But what sounds straightforward is, in practice, quite complex.

There are two main approaches to benchmarking: firms can compare themselves to their peers, or they can benchmark their performance against internally set key performance indicators (KPIs). Even if firms choose to benchmark themselves against internal KPIs, they should have some knowledge of what other treasuries are doing in order to set realistic KPIs or understand the differences. Across both types of benchmarking only one thing is clear: there is no 'one measure fits all' approach.

The idea of tracking best practice in treasury operations gained popularity following the introduction of the Sarbanes-Oxley Act (SOX) in the US in 2002 along with similar legislation elsewhere in the world. In a 2012 Journal of Corporate Treasury Management paper, 'Monitoring, benchmarking and improving treasury performance: the practical application of KPIs in treasury', Paul Higdon, Chief Technology Officer (CTO) at IT2 Treasury Solutions (now part of Wall Street Systems), stated that these regulations required "a very substantial increase in controls and the scope of documentation requirements in treasury and finance operations". This development in part defined the emerging standards of best practice for corporate treasury operation, he observed.

Another factor driving this change was the devastating losses suffered by companies such as Enron due to fraud or treasury errors. "At the time when the response to the events that led to SOX introduction was being evaluated, one general conclusion was that specific individuals within corporations or institutions were seen to be at fault," stated Higdon. "Therefore tighter regulation of organisations was needed to ensure that the company and shareholders were protected against such rogue employees." This objective was achieved by improving internal processes, reporting and controls.

Fast forward six years and the financial crisis threw another spanner in the works. One of the striking post-crisis changes for treasury is the recognition that once considered routine tasks now carry significant risk and associated overheads. Such tasks included raising cash funds and analysing cash availability. Treasury's role in cash management, funding, financial risk management and other key areas is now seen to be critical to the profitability, smooth operation and even viability of an organisation.

It is understandable in the light of this new environment that corporate treasuries should seek to determine how well they are performing in their roles. However, there is no standard approach or readily available guidance. For some corporate treasuries, external input from consultancies is seen as the key to benchmarking. Others adopt internal measures but, for many benchmarking is simply not undertaken.

"Benchmarking is essential in measuring the performance of the treasury team as a whole and also for measuring individuals' performance," says Paul Stheeman, an independent treasury consultant, based in Germany. "Every company wants to be best-in-class and there is no reason for the treasury function to be excluded from that aim."

Companies should combine the traditional benchmarking of measuring performance against their peers with the internal, KPI approach. "Treasuries have to follow company strategy and adhere to it, but they also should measure their performance versus their peers," Stheeman advises.

Here at Treasury Today we have been conducting benchmarking studies since 2009. More recently we have included a separate section on KPIs and, with the input of our corporate respondents we have developed seven key treasury disciplines against which KPIs are deployed. The table below defines these treasury disciplines and the top three KPIs used against each. In more recent studies we are now identifying the actual measures companies are achieving against the above and allowing respondents to benchmark themselves not only against the whole Study universe but also against their respective industry sector.

Table 1 – Top three KPIs

Treasury discipline	No 1 KPI	No2 KPI	No 3 KPI
Overall treasury efficiency.	Cash visibility.	Cash pooling structures.	Costs as a percentage of total treasury costs or revenue.
Core cash management efficiency.	Cash flow forecasting accuracy.	Cash pooling structures.	Balance/transaction reporting.
Working capital management.	Days sales outstanding (DSO).	Days payables outstanding (DPO).	Days inventory outstanding (DIO).
Liquidity management.	Cash flow forecasting accuracy.	Short-term investments.	Short-term funding.
Risk management.	Mark-to-market.	Hedging effectiveness.	Value-at-Risk (VaR).
Funding/balance sheet management.	Net debt/EBITDA.	Net interest expense.	Weighted average cost of capital (WACC).

Source: Treasury Today 2012 European Corporate Treasury Benchmarking Study

Benchmarking against peers

One of the most significant challenges of benchmarking how a treasury is performing against its peer group is determining exactly who the company's peers are. Corporate treasuries – like corporates themselves – come in all different shapes and sizes.

Dino Nicolaides, Head of the Corporate Treasury Advisory Team in London for consultancy Deloitte, says benchmarking is about understanding how a company's treasury function compares to those of similar companies. "It is how you define 'similar' that can vary," he says. "This can be based on industry sector, company size irrespective of the industry in which you operate, or based on geographical location. How you define your peer group will determine the value you get out of the benchmarking exercise."

Bas Rebel, Senior Director, treasury advisory at PwC in the Netherlands, says that for "quite some time" benchmarking should have been higher on the agenda of corporate treasurers, but wasn't. "The key problem is that treasurers still believe their situation and company structure is unique and therefore difficult to compare with the outside world," he says. However, recently PwC has been asked more frequently by clients about how other treasuries are organised and what their focus is. "So there is an interest to understand how peers are working. However, that is still not close to formal benchmarking. The one situation where we are involved in a more formal benchmarking against peers is when a business case for change has to be made or approved."

> "Benchmarking gives us the opportunity to identify where we stand and how we develop over time among our peers. The external comparison is essential for the progress of a unique corporate function like treasury."
>
> Karsten Kabas, Head of Corporate Treasury, Merz GmbH & Co. KGaA

In order to have meaningful comparisons, treasurers need more than a couple of corporates with whom they are comparing themselves. Once a reasonable sample of peers is established, the next challenge is to recognise that every organisation is different, with its own treasury policy, structure and risk appetite. "You need to flex the statistics in order to ensure you are comparing apples with apples. For example, if you compare two FTSE100 companies, one might be operating in ten countries and the other in 150. The latter will be using very sophisticated cash management techniques in order to concentrate cash and move it around the world. Comparing those cash management procedures with the ones employed by the former company won't be suitable" says Nicolaides.

"Benchmarking gives us the opportunity to identify where we stand and how we develop over time among our peers. The external comparison is essential for the progress of a unique corporate function like treasury." Karsten Kabas, Head of Corporate Treasury, Merz GmbH & Co. KGaA

Setting KPIs

In a February 2012 blog, IT2's Higdon writes that KPIs provide "a structured and objective environment for assessing the effectiveness, accuracy and rate of improvement of critical treasury processes". Treasury KPIs are valuable at all levels of an organisation, potentially enhancing the quality, level of policy compliance and efficiency of treasury.

"Corporate treasurers are increasingly being encouraged to adopt a KPI programme, under the direction of senior management, often at Board level," he writes. "A KPI programme is typically delivered through the implementation of an enhanced treasury policy, and manifests as a new set of mandatory processes, integrated with the treasury workflow."

But as with benchmarking against peers, a similar conundrum exists in setting KPIs – which ones are appropriate for a particular treasury operation? The choice of the optimal set of KPIs for a particular treasury can be an exacting exercise as the wide-ranging objectives include streamlining management reporting, improving the quality of all kinds of treasury operations and measuring, analysing and documenting operational compliance with treasury policy. The set of KPIs ultimately selected for a particular treasury will not only reflect the specific treasury policy and workflows that are in place; it must also reflect the business policies and priorities of the whole organisation. The KPI selection that works best for a given treasury will have been chosen through detailed analysis of those features of treasury operations that correspond to the highest levels of risk exposure.

"The treasury employs a variety of KPIs to ensure benchmarking efficiency. These include transaction costs, refinancing risk, covenant ratios and FX hedging amongst others," says Daniele Vecchi, Group Treasurer at Majid Al Futtaim in Dubai.

Intelligence gathering for establishing KPIs is a major challenge. A corporate treasurer can contact their treasury peers and friends, and try to glean information about their practices, but such an approach is fairly ad hoc. Ideally the treasurer needs to get a larger statistical sample. But this sort of benchmarking must be used carefully. A large statistical survey may tell you that 35% of treasuries practice A and 25% do B, etc. But what does that really tell you? Jeff Wallace, Managing Director at US-based Debt Compliance Services comments "economic factors drive different behaviours. Benchmarking should take into account what is driving different behaviours in a particular set of treasury practices. Sometimes it will be volume in terms of the number of transactions, whereas sometimes it is the industry itself."

While many observers believe industry is a big driver of differences in treasury practice, others point out that, at the end of the day, treasuries are pretty much the same. Money goes in and comes out, and there are risks to manage.

Stheeman outlines the main KPIs that companies most often use to measure their performance. These cover:

- Personnel – costs.
- Cycle times – based on regular types of activities such as cash forecasting, bank account reconciliation, cash pooling, etc.
- Cash flow forecasting – balance versus actual.
- Stranded cash reduction – reducing trapped cash or having the amounts at as low a level as possible.
- Counterparty risk – how high losses are over time and how to reduce them.
- FX and interest rate performance – there are several ways to choose a benchmark, but an appropriate one needs to be found and measured against.

- Bank charges – how much are you paying for treasury services and which banks are you using.
- Bank relationships – related to the above. How well are your banks doing and how do they compare with each other?
- Cost of credit – how does this compare to other organisations and internal targets?

"The main focus of our benchmarking processes is related to maintaining relationships with our banks. In essence this means: how we choose the banks; how we manage our FX exposures; and how we manage our finance costs," says Kamal Goyal, CFO at Alumco in the United Arab Emirates (UAE).

> "The treasury employs a variety of KPIs to ensure benchmarking efficiency. These include transaction costs, refinancing risk, covenant ratios and FX hedging amongst others."
>
> Daniele Vecchi, Group Treasurer at Majid Al Futtaim in Dubai.

In setting KPIs treasuries should set realistic goals but also ensure these goals are not too easy to achieve. Benchmarking models coming out of spreadsheets that are so complex no-one understands them, are not any use. You need to understand the KPIs and how they are measured or else you will not get a result with which you can be comfortable.

In order to determine the right set of KPIs for any particular situation, the treasurer needs to be very clear about their organisational objectives and about the guidelines defining how those objectives are to be achieved — the treasury policy. When selecting KPIs, the organisation's current or future capability to deliver the required results, at the required levels of accuracy and timeliness, should be considered carefully. The selection of the appropriate KPIs for a given treasury naturally depends on the nature of the company's business, as well as treasury's defined role within it.

Nicolaides says a number of metrics and how they differ between companies should be considered during a benchmarking exercise. These include:

- **Treasury organisational structure.** How are treasury activities around the world organised? Some organisations may centralise at headquarters (HQ), while others have group treasury but delegate to regional treasury centres to take over activity in that continent. In benchmarking, the treasury must compare itself to similar companies of similar size in similar countries and ask "are we falling short of this peer group company?"
- **Quality and skills of key people within the treasury function.** Key individuals that determine treasury policy and strategy at central and regional centres should be compared with the key individuals in similar organisations. Is a company employing people of the same calibre?
- **Governance.** The involvement of the Board in terms of overall treasury strategy and how authorities are delegated within the organisations, from the Board to the CTO, finance, treasury committee or even in regions, should be compared and analysed.
- **Policies.** This can be a difficult area to tackle. You have to isolate the risk appetite of particular organisations. If one organisation has insignificant foreign exchange (FX) risk, their policy will be to ignore it. Another organisation that has extensive FX risk exposures will engage in significant hedging activities. If you compare their treasury policies, you should isolate risk appetite because it is irrelevant.
- **Core treasury activity.** How a treasury identifies, measures and manages risk, including FX, interest rate, counterparty risk, cash management and liquidity risk. Companies should look at procedures and again isolate the risk appetite of other organisations if irrelevant. How do the procedures of one organisation in terms of identifying risk compare with those of another? Does the treasury have a procedure to identify whether there is a risk or whether it has gone undetected? Are there processes over time to manage and observe changes in risk exposures?
- **Operational procedures.** Such procedures include front office dealing activities such as derivatives trading, hedging, confirmation and settlement. How does the treasury compare with similar organisations? Systems and technology also should be considered – how automated are these processes versus the peer group? Where is the technology in terms of the industry practice?
- **Reporting.** This is strongly related to KPIs, on which the treasury report to senior management. Benchmarking should consider how complete the KPIs are and how the reporting on them compares with other organisations.

Getting it right

What is clear is that benchmarking in treasury has to be managed with great care. It is important to measure the right things and it is very easy to measure the wrong things.

For example, a focus on funding costs can overlook the fact that the funding itself may not be required, if the treasury improved its management of working capital. Additionally, a good working capital metric, such as cash conversion cycle (CCC), may push higher costs elsewhere in the business. For example, it can encourage business units to give expensive early payment discounts, or secure longer payment terms from suppliers, who may incorporate a higher funding cost in their base prices. Finally, a focus on bank charges may reduce the bank charges, but will this result in damage to banking relations which causes significant increased cost further down the line?

The main point is that treasury activities, while they need to be monitored for efficiency, also need to be looked at in the context of their overall cost. This is always extremely difficult and it requires a high level of organisational maturity: the organisation as a whole needs to be very clear as to its priorities.

Learning what your peers are doing always helps in this process and our Treasury Today Benchmarking Studies are proving very popular among the corporate treasury world, particularly the KPI section. As a corporate there is only one way to get the full results of this year's surveys – participate. So if you wish to benchmark your KPIs against the industry and learn what else other companies are doing, please participate in these Studies. ■

Global Cash Management

Joy Macknight (Treasury Today): The global economic climate remains challenging and many banks are still facing ratings issues. How is the overall economic state-of-play impacting corporate cash management?

Neil Peacock (ABB): To a certain extent the most recent developments are not having much of an impact, when put into the context of the past five years. Since 2007/8, the focus has been on ensuring that we have visibility and control – effectively centralising as much of our cash as possible to ensure it is available. Having visibility over cash in Egypt, Cyprus or Greece is one thing, but being able to use it is another.

In more restrictive countries in terms of moving cash in and out, such as China, India and Malaysia, we try to minimise risk by knowing where the cash is and how we can access it. These are the key drivers for cash management today – the immediate impact of recent events is not influencing us to do things differently to what we have been doing for the past three or four years.

Joy Macknight (Treasury Today): Does that resonate with the other corporates in the room?

Michal Kawski (GM&T): Yes absolutely, I agree with that. Fundamentally nothing has changed in terms of the methodologies and tools we are using. However, recent events inside the Eurozone, or the situation in Egypt for example, are interesting signs of the times. In the Eurozone, we are centralising our euro liquidity into one place, just in case another euro crisis erupts at some point. The Single Euro Payments Area (SEPA) project gave us the opportunity to further optimise our euro liquidity.

James Marshall (Virgin Media): From a consumer-based corporate perspective – and a slight aside from treasury – we are keeping an eye on rising costs, which will impact customers' ability to carry on subscribing to our products. Home connectivity and entertainment is no longer regarded as discretionary for many families, as it has proven to be of greater value compared with other activities, but nevertheless consumers' incomes are being squeezed.

Virgin Media's business is based in the UK and in sterling, but much of our capital expenditure (capex) is used to import equipment. Over the past few years we have seen more demands placed on us in terms of trade finance solutions and letters of credit (LCs), for example, which we have not had to deal with before; but this is perhaps symptomatic of a period of international fiscal uncertainty.

Participants

Steve Everett
Global Head of Cash Management
RBS

Michal Kawski
Head of Treasury
GAZPROM

James Marshall
Assistant Group Treasurer
Virgin media

John Murray
EMEA Corporate and Public Sector Cash Sales Head, Treasury and Trade Solutions
citi

Neil Peacock
Global Head of Cash Management
ABB

Filipe Simão
Head of Client Advisory, BNP Cash Management
BNP PARIBAS

Chair

Joy Macknight
Editorial Director
treasurytoday

John Murray (Citi): It is important to look at liquidity from a global standpoint, as opposed to solely from a European perspective. By concentrating funds in various currencies in a single location, clients are now challenging their banks to come up with creative solutions, particularly in trapped markets such as China and Russia. They are asking their banks how they can do more to get trapped cash out of these markets and concentrated into a single location.

Steve Everett (RBS): China is at an interesting stage, as it opens up further with renminbi (RMB) internationalisation. However, it is important to remember some of the lessons from other countries in the past, particularly in terms of trapped cash, and think about what could or couldn't happen in China if a slowdown emerges.

Filipe Simão (BNP Paribas): Interestingly, the Chinese word for crisis includes both danger and opportunity – and our customers are increasingly asking for greater flexibility, a word that I will stress. It is flexibility that will ensure that the company remains agile to either postpone opportunities or take advantage of them. Importantly, flexibility is key in the way in which liquidity structures are implemented, electronic banking (e-banking) solutions are chosen and SEPA XML is leveraged.

Neil Peacock (ABB): Although we have said a lot about China, we also need to consider the emerging markets, particularly in Latin America, such as Brazil, Argentina and Venezuela. We had quite high hopes for these countries, both in terms of cash generation and being able to access that cash. But we have seen some worrying signs: economic slowdown, increased controls and inflation. I think you are right, Steve, that we mustn't forget that if things aren't resolved in the short term to everyone's satisfaction, things can change back the other way quite quickly. But I am quite positive about China.

Steve Everett (RBS): Going back two years ago, we were constantly answering questions about the euro and what should people be doing, particularly US clients. However this has abated and we now hear minimal concerns around the Eurozone. Whilst there are lingering problems and occasionally new issues crop up, people are broadly content with what they need to do and feel that they are in control. I agree that it is very much an emerging markets issue now.

Joy Macknight (Treasury Today): Are corporates finding it easier to attain the desired level of cash visibility, or is there something you need to do/have in order to get to the next level?

Neil Peacock (ABB): ABB experienced a crisis in 2002, which forced it to put in place clear, accurate cash forecasting because without that it would not have had support from its banks. So for any company that is thinking about implementing a cash forecasting process, I can recommend having a crisis because there is nothing like it to focus the mind. ABB is now in the position where what was put in place ten years ago is still extremely effective today. Having good visibility and control over cash definitely helped us during the 2008 financial crisis. But it is not one of those things that you put in place and then sit back. It's continually evolving and as markets open up, technology improves and new structures and products become available to be able to centralise cash, then we need to be ready to take advantage of those developments.

James Marshall (Virgin Media): I agree with the sentiment that a crisis galvanises action to generate better cash forecasting. Due to the financial crisis, and to a certain extent our shareholders support for share buybacks, we have been able to drive down our cash balances. We can now manage cash at a much lower level as a result of better forecasting.

Michal Kawski (GM&T): GM&T's formal treasury activities were set up in the summer of 2008, so you really can't think of a better time for setting up a treasury function. This whole situation allows us to build a high profile within the organisation. But it's not only crises that give us this opportunity. Energy or commodity trading is a volatile business today, so without good cash flow forecasting and building provisions against volatility, we wouldn't be able to operate.

Joy Macknight (Treasury Today): There has been a lot of press about corporates holding record levels of cash, yet due to Basel III short-term deposits are not so attractive for banks. Where are corporates placing their cash?

Steve Everett (RBS): There are two dynamics at play here. Firstly, banks need to balance their balance sheets, only taking deposits providing we can lend them out. Currently we have excess cash and if we cannot use it, we need to review our pricing in line with the cost of holding the excess liquidity.

Secondly, Basel III regulations introducing liquidity coverage ratios mean certain deposit types will be fairly punitive to hold. As a result banks will face substantial costs for traditional short-term time deposits, eg those under one month. That will have a knock-on impact on our clients. We have already started thinking about our product propositions and pricing, but the unintended consequences for corporates will put a question mark over where they will be able to place this short-term cash.

John Murray (Citi): I agree with you. I would add, from a banking perspective, it is important that we still support our clients and provide a safe, secure environment where they can leave their funds with a counterparty that they trust. Clients are not necessarily always chasing yield, but because the environment has improved they are starting to seek additional incremental basis points.

Filipe Simão (BNP Paribas): Although Basel III gives us some leeway in reaching those famous liquidity coverage ratio (LCR) levels, many banks want to achieve the ratios ahead of schedule. Therefore, banks are very keen to accept corporate deposits because they are considered more stable than wholesale deposits. As you mentioned John, we see a growing attraction for yield, but counterparty risk is still very important. When you see market turmoil such as recently when the Portuguese stock exchange lost 5% or the events in Egypt, these remind us that risk is still important, be it sovereign or bank risk.

Michal Kawski (GM&T): What we learned in 2008 was that there can be counterparty risk on the banking side, which was a major change in the treasurer's paradigm. Before that, depositing money with an institution that was rated much higher than you was a no-brainer. Since then companies began building up their own investment policy, spreading risk across different institutions and products. This is when money market funds (MMFs) took off because everyone realised that suddenly something which is AAA rated one day could be BBB rated the next, even large European financial institutions.

GM&T now has a wider credit risk assessment policy and has diversified its portfolio across many banks and products, which is similar to other corporates. An interesting question is what will happen to the MMF industry? This will be an interesting debate over the next year or so.

Neil Peacock (ABB): I would just like to add that one alternative is to invest your cash in acquisitions. Could you achieve a better return by acquiring companies and developing your business, which makes sense economically, rather than getting three basis points on a short-term deposit?

From our point of view, it does make sense and we have been very acquisitive. Over two years ago, we had €10 billion in cash and no yield. If you are a shareholder, is that good enough? No. Can you get a better return by acquiring companies in different markets, such as China or North America? Those are some of the decisions that need to be looked at from a strategic business standpoint.

Filipe Simão
BNP Paribas

James Marshall (Virgin Media): From a governance perspective, we have an audit committee who provides oversight to many of the company's financial operations, one responsibility of which is to look at our treasury and credit risk policies. Interestingly, their attention has been focused mainly on the products, ratings, funds, security and plans, rather than yield.

To your point Neil, our cash has been used to invest in the business and as a result we were not as leveraged as we could be. We have gone through a deleveraging process over the past few years with the support of our shareholders. But this was a different approach compared with pre-2008.

Joy Macknight (Treasury Today): In the year of SEPA implementation, as we head towards the deadline of 1st February 2014, what challenges still remain and what is your estimation of corporate readiness?

John Murray (Citi): SEPA is proving to be a challenge for corporates throughout 2013. Our main priority is to ensure that our clients have the support they need to become compliant. If you look at the rate of uptake of SEPA Credit Transfers (SCTs), as of August it is about 42%; whereas the rate of uptake of SEPA Direct Debits (SDDs) is only about 2.5%. This illustrates the readiness of the market. A particular challenge, therefore, for corporates is to be ready for SDDs. From a payments perspective, you will still be able to send wires; but the concern will be one of confidentiality should you need to make payroll payments. We are focused on ensuring that our clients are aware of the challenges, the benefits, and the risk of doing nothing – what will happen after 1st February 2014?

Neil Peacock (ABB): At the beginning, treasury and shared services were the only ones involved in SEPA compliance. And then someone said 'What about payroll? What about HR?' There was a realisation that getting the other business units involved is quite important – what if we aren't able to pay our employees on time?

John Murray (Citi): Additionally, are your customers ready? Will you actually receive your receipts? And if you don't, what impact will it have on your business? Payments is a network business and any network is only as good as its weakest node.

Michal Kawski (GM&T): When operating in a number of European countries, you realise that there are plenty of local regulations behind SDDs, which effectively means a slightly different SEPA wherever you go. SDDs may be relatively straightforward in the Netherlands, for example, but in Germany written consent is required from some counterparties, on top of technical challenges and a massive bureaucratic hurdle. We actually started our SDD project with a conference call with one of our banks just to discuss the situation country-by-country. Therefore, I can understand why SDD projects are still behind schedule. We are still not fully migrated but are on track for the deadline.

Filipe Simão (BNP Paribas): We are not too concerned with SCT readiness. The migration rate is relatively high, banks are reachable and clients can easily find software solutions for converting file formats and International Bank Account Numbers (IBANs). However, on the collections side, SDD still has a very low migration rate and the migration effort required can be significant. In most countries, the SDD creditor-driven mandate flow works in the opposite way to the legacy direct debit. One piece of advice is for clients to talk to their IT vendors and banks who have in-depth migration expertise. Either way, action is to be taken now. As we get closer to the end-date, the resources available on the market will become scarce and expensive. Corporates should not assume that the deadline will be pushed back. The regulators in all European countries are committed to maintaining the end-date at 1st February 2014.

Clearly the focus today is regulatory, which is correct. There will be plenty of time to look at leveraging SEPA opportunities next year. This will include cross-border direct debits, payment factories and payments-on-behalf-of (POBO).

Neil Peacock (ABB): Certainly we have taken a country-by-country approach because there are different levels of SEPA readiness. Finland, for example, has been 100% compliant for over a year now and we are using them as a role model, setting them up as the SEPA experts and using them as the consultants for the rest of the group. But we used SEPA not just to be compliant from a regulatory perspective, but actually to drive a pan-European cash management project.

Joy Macknight (Treasury Today): Do you think that corporates will be able to carry the momentum through and leverage the benefits post-deadline?

Neil Peacock (ABB): As long as treasurers start thinking about the rest of 2014 and ensuring that they have a budget available then yes they can do it. But they need to be clear as to what they want to achieve. We are trying to take advantage of the benefits that SEPA will bring in terms of bank account and bank rationalisation, as well as payment processes standardisation. Not doing that now seems like a missed opportunity and a duplication of work.

John Murray (Citi): I agree that it is potentially a missed opportunity, but I think that at the moment corporates are primarily focused on being compliant and will then focus on embracing the opportunity to reduce their bank accounts to maybe one or two per country or even one across the whole of the Eurozone. Our clients are starting to consider the longer-term benefits as we talk to them about the opportunities that SEPA can bring.

Michal Kawski (GM&T): The SEPA topic can be split into two aspects: credits and debits. We addressed the credits side more than two years ago. From the costing perspective, generating those payments is cheaper, which is a fantastic step forward. Debits, on the other hand, are a different story but I agree that there are many areas where corporates can improve their existing cash management structures, such as centralising collections in one bank and having just one account, for example, based in London.

John Murray
Citi

Neil Peacock (ABB): One of the frustrations I have is the lack of harmonisation within Europe from a tax payment standpoint. So it would be great to have one central bank account, but I will still need to have a bank account in Italy, Portugal and France, for example, in order to make certain types of payments or collections.

Joy Macknight (Treasury Today): What challenges remain in terms of setting up POBO and collections-on-behalf-of (COBO) structures?

Filipe Simão (BNP Paribas): At BNP Paribas, we have seen corporates doing POBOs since 2003, so well before SEPA. The difference is that at the time companies were doing POBO only for cross-border payments or for payments in non-functional currencies. The way the accounting implications work are thus well known and implemented. Globally, the difficulty with POBO is to make sure that the debtor information reaches the beneficiary and that they are able to match it, otherwise the invoice will remain open. Additionally, in some countries such as Poland, it is not possible to make payments through a

POBO model. It may also trigger regulatory reporting issues when used on non-resident accounts for some payments. But clearly POBO is something which has been at the heart of the in-house banking (IHB) solutions since the turn of the century; SEPA just makes it much easier.

James Marshall
Virgin Media

James Marshall (Virgin Media): Because of the structure of Virgin Media, POBO is something we have always struggled with. For example, we still need to split out Virgin Mobile from Virgin Media for all employees and capex payables, but the difficulty has always been that if one shared service centre (SSC) is processing bills there is complexity in having them all paid out from the correct entity, which adds to the confusion.

John Murray (Citi): I think technology will be the enabler of POBO – having one ERP system will help facilitate POBO. Having one single instance, with all entities on the same system, will make life a lot easier for the IHB in terms of managing inter-company lending.

Neil Peacock (ABB): The technology is there and corporates need to understand what is available. On the back side of POBO and COBO is the virtual accounts set-up. This is where COBO really makes sense because you can have a million virtual bank accounts and allocate one to each of your customers and business units – it makes the reconciliation process a lot easier. Then you don't necessarily need a single ERP solution, as you can split MT940s based on the virtual account set-up. And if we can do it in Europe, then why not on a global scale?

Filipe Simão (BNP Paribas): Still on the technology front, corporates have started developing XML to do their mandatory technical migration to SCTs, and then discovered that they can leverage the same formats to make payments in other currencies. So XML is not just for SEPA.

Joy Macknight (Treasury Today): Regulations are coming thick and fast; some have a direct impact on corporates and some indirect. How are these new regulations expected to change the treasurer's behaviour and how can banks help their clients best prepare for what is coming down the line?

Steve Everett (RBS): The ultimate knock-on impact for corporates with regards to all of the new regulation is the amount of internal change it means for the banks. A large proportion of every bank's investment budget is now being spent on these regulatory projects, which intuitively must have a knock-on impact in terms of the discretionary value-added spend that we would normally make. As a result innovation in new services and products is either being reduced or is delivered slower than in the past. This problem is the same for all banks.

John Murray (Citi): Banks spend lot of time reviewing and understanding the implications of local regulations to ensure they are aware of how these will impact their business and their clients in all the markets in which they operate. To help our clients, Citi has a knowledge of regulation not just within the Eurozone or North America, but in all the countries where we operate. This helps us to understand the local challenges. So as corporates do business around the world and seek guidance, we have people with local knowledge and experience to help them through the regulatory challenges.

Neil Peacock (ABB): Corporates are a little bit like water – we always find the path of least resistance. If an obstacle is put in its way, the water finds a way round it. For example, after the financial crisis, when bank funding dried up, the bond markets became much more active. Similarly, if the Financial Transaction Tax (FTT) ever gets imposed, corporates will just deal where it is not implemented.

Filipe Simão (BNP Paribas): The discussions on the FTT are still ongoing, with many banks, officials and economists voicing their concerns as to the dramatic implications if it is implemented as currently proposed by the European Commission (EC).

Michal Kawski (GM&T): All the regulations we've been talking about will impact what we do: Basel affects the funding side of our operations; FTT affects our transactions and the financial products we use; and the European Market Infrastructure Regulation (EMIR) will affect the derivatives side.

EMIR has been at the top of our agenda for the past 24 months at least. I know there has been a lot of debate within the treasury industry around what it actually means for corporates. Suddenly companies could be forced to make a choice: are they going to invest money in acquisitions or support the liquidity of a derivative portfolio?

Of course, given the latest rules recently put in place, this is probably of less relevance. However, there remain reporting requirements, which is a fairly new workload for treasurers. A number of my peers have told me that they are not sure about the formats and exactly what they are supposed to be reporting. They have to report positions from the past 18 months, so it means plenty of new challenges and much IT effort as well.

Joy Macknight (Treasury Today): Many corporates are looking to alternative sources of funding. What are the corporates in the room doing?

James Marshall (Virgin Media): Virgin Media had been on a deleveraging path until the Liberty Global merger and we had begun discussions around how to improving working capital with the senior executive team. This year was the first that our senior executives have working capital metrics included in their bonus calculations. The purpose of this was to enable the company to carry on its deleveraging path. The next set of discussions are focusing on supply chain finance (SCF) and other routes to reaping more working capital benefits. Liberty wholeheartedly supports this initiative and is actively pursuing this programme across Europe.

Michal Kawski (GM&T): In terms of alternative sources of funding, I've been observing the development of the retail bond market. There were a number of successful issuances in the London markets, and I also heard about a retail bond issuance in Poland a few months ago where the biggest refinery in Poland issued its bonds and they were sold out in two days – generating a few hundred million zloty. This concept seems to be attracting a new group of investors.

Filipe Simão (BNP Paribas): We see a growing interest in terms of public bonds and private placements as a way for small and medium-sized enterprises (SMEs) to get mid-term financing. We are also teaming up with a treasurers association to see how we can help SMEs tap the commercial paper markets. Obviously these are instruments that are more associated with companies which are publically rated, but an increasing number of SMEs are interested.

Michal Kawski (GM&T): That's interesting because the message we normally receive about the private placement market is that it is long term, for example pension funds.

Filipe Simão (BNP Paribas): They tend to be long term, but we start looking at these types of products for maturities of three years.

Steve Everett
RBS

Joy Macknight (Treasury Today): Is there a tighter integration happening with cash management and trade finance, and if so, how does that help with cash forecasting?

Michal Kawski (GM&T): I can't even imagine trade finance and treasury working separately in our environment. We have trade finance facilities which involve both issuing letters of credit (LCs) and a funding element, so they are tightly aligned and reporting is done together.

Steve Everett (RBS): That is interesting Michal, because we have regularly put trade people in front of cash people and the general reaction is 'that would be a nice to have'. I think it comes down to the industry you operate in. Personally I find it surprising that cash and trade are still not coming together as there has to be an opportunity around the use of liquidity, supply chain financing and forecasting across the two product sets.

Filipe Simão (BNP Paribas): It depends on the industry, but also geography – cash and trade are more integrated in Asia, but more piecemeal in Europe.

Neil Peacock (ABB): We have two distinct departments and actually sit on different floors, but have become closer together in the last year or so through working on shared projects such as SCF or advanced trade payable finance. We are also working together on reducing the number of bank accounts and banks, as well as centralising and standardising the issuance of guarantees. This is exactly what we are trying to do on the cash management side as well.

John Murray (Citi): At Citi we are constantly seeking innovative ways to further integrate cash and trade, particularly in the purchase-to-pay space, and specifically with regards to enabling our clients to leverage their invoices and pay suppliers.

Neil Peacock (ABB): Adding to John's point, at ABB the purchase-to-pay is part of a different function, in a different building. It is part of the shared accounting services, which is part of finance and controlling. However, in some of the projects we are involved in we are working much closer with them, as well as with order-to-cash.

Michal Kawski (GM&T): Reducing the number of bank accounts is an interesting challenge for us at the moment. Each time we set up a trade finance facility with a bank, we need to open bank accounts for four entities. So if you multiply that by another five facilities, then the number of bank accounts increases significantly. An interesting challenge would be to work with our banks on rationalising the number of bank accounts and thinking about the structures which would allow a simplification. I know that there are difficulties in doing this, as there are many legal constraints that would block this process, but it would be an interesting challenge to take on.

Joy Macknight (Treasury Today): **Obviously what is happening in the market place is placing some strain on the corporate-to-bank relationship, but how are banks living up to the corporates' expectations and what could they be doing better?**

James Marshall (Virgin Media): Virgin Media has been through a period of leveraging up and back down again, but in all fairness our relationships with our banks have always been very constructive. We have looked to do a lot of business with our lending banks and that has been an important part of our approach. One thing that has been interesting, certainly since 2008, is that we are now having more conversations with banks that maybe wouldn't have been interested in offering us transaction services before, but are now very keen to have that discussion. To a certain extent, we are always happy to chat if it promotes further competition and new ideas in the marketplace.

Steve Everett (RBS): But equally, providing that the core lenders can provide the services and the stability of systems, probably 95 times out of 100 corporates are sticking with the banks they know. A good two-way commitment is crucial, and it is very difficult to gain new clients if you are not in the relationship as a primary lender.

John Murray (Citi): James made a very good point – since the financial crisis, a number of new banks have entered transaction services because they see the benefits of having a long-term relationship with the client and supporting them on a day-to-day basis. Maintaining the bank account provides an opportunity to offer new solutions and services to a client. If you have that account you are able to have a deeper dialogue and more knowledge of the client's needs and subsequently identify new solutions that the client could benefit from. From a bank perspective, it is important to understand the client's needs, to listen and to identify how the bank can help the client achieve its objectives. I think banks are getting better at that.

Joy Macknight (Treasury Today): **Do the corporates in the room agree with John?**

Neil Peacock (ABB): Yes, I actually think it is a great time to be in a corporate in transaction services because I think there are maybe ten to a dozen banks that are world class in terms of cash management. Since the crisis much more investment has been put into transaction services and there are some very good people involved. Many corporates will stay with their incumbent provider because switching would only deliver an incremental – not a dramatic – improvement in the products and service level. If you are with one of those dozen, you are going to get good service, products and support – and I think we are quite lucky in that respect.

We have been through some very detailed RFPs in Europe and the US in the past six months, and to a certain extent it wouldn't have mattered which bank we chose because they would all

Neil Peacock
ABB

have done a good job. It is really about choosing between the one with rainbow sprinkles and an extra cherry, or the one with chocolate and fudge. We are quite lucky, and the financial crisis actually helped that a bit because banks moved away from investment and equity trading and placed more emphasis on its transaction banking business.

Filipe Simão (BNP Paribas): Do you see a difference between these ten to 12 world class cash management banks or is global transaction banking a commodity? Are there other subsets within the commodity, such as value-added services, flexibility or a long-term relationship commitment, that corporates perceive as differentiators?

Neil Peacock (ABB): They aren't all equal, just slightly different flavours. We looked at nine different categories and 37 different sub-categories, including ratings, service, structure, technology and capability. Geographic reach was also an important criteria – if we have a requirement for a bank account in Italy for collection purposes, does the bank have a full branch service in the country, or is it a rep office, or do they use a partner bank? But this is small stuff compared with the big picture.

James Marshall (Virgin Media): As a consumer business, through our RFPs we evaluate the whole customer experience. From start to finish the customer experience has to be outstanding. Today our bank review meetings are not about problems, but what new technology might look like, for example mobile payments (m-payments). A number of our banks have been invited to make presentations on banking technology to help us get slightly ahead of the curve. We want to make sure that if customers want to pay us via tablets and phones for example, then we have the ability to receive their money in whatever way makes sense for them.

Neil Peacock (ABB): James, you hit upon a pertinent point, which comes back to Filipe's question as well, what is the best fit for the underlying business? If you require m-payments then you might choose the leading bank in m-payments. We make the same decisions: in the US, for example, we were offered one solution that was fantastic, but it didn't fit the business requirements as closely as the one that wasn't quite as good. So we went with the solution that was the best fit for our business.

In addition, we are looking for a long-term commitment – not just two or three years, as I don't think we will continue to do RFPs every two or three years, but more like six or seven years. Therefore, we are also looking at the bank's long-term ambitions and its creditworthiness as well.

Michal Kawski (GM&T): We have a centralised treasury function with global business operations, so it has been quite challenging to find a bank or banks that are able to support this. We wanted a bank that really understands our business – and how it is different to other businesses – and which is proactive enough to address our needs. During the RFP process we learned that some banks have a centralised approach to providing cash management services globally, whereas others are more decentralised. After the process we were absolutely convinced that the solution we decided on was a good choice and fitted well with our business.

Joy Macknight (Treasury Today): And the final question, what are your predictions for hot topics in 2014?

Steve Everett (RBS): The beginning of 2014 is going to be all about SEPA, whether we like it or not. The industry will be trying to cope with preparing for last minute readiness or dealing with the fallout of issues that people hadn't fully thought through. The rest of the year will see a lot of the other regulations coming closer to live dates – Basel III, Dodd-Frank – and as a result I'm afraid there won't be much in the way of new developments happening, as most banks and corporates remain focused on keeping their businesses on the road.

Michal Kawski (GM&T): I agree that regulations will dominate the agenda, unless things heat up in the political sphere. The unwinding of quantitative easing (QE) at some point might prove to be an interesting challenge for all of us, but it is more likely to be regulatory changes in 2014.

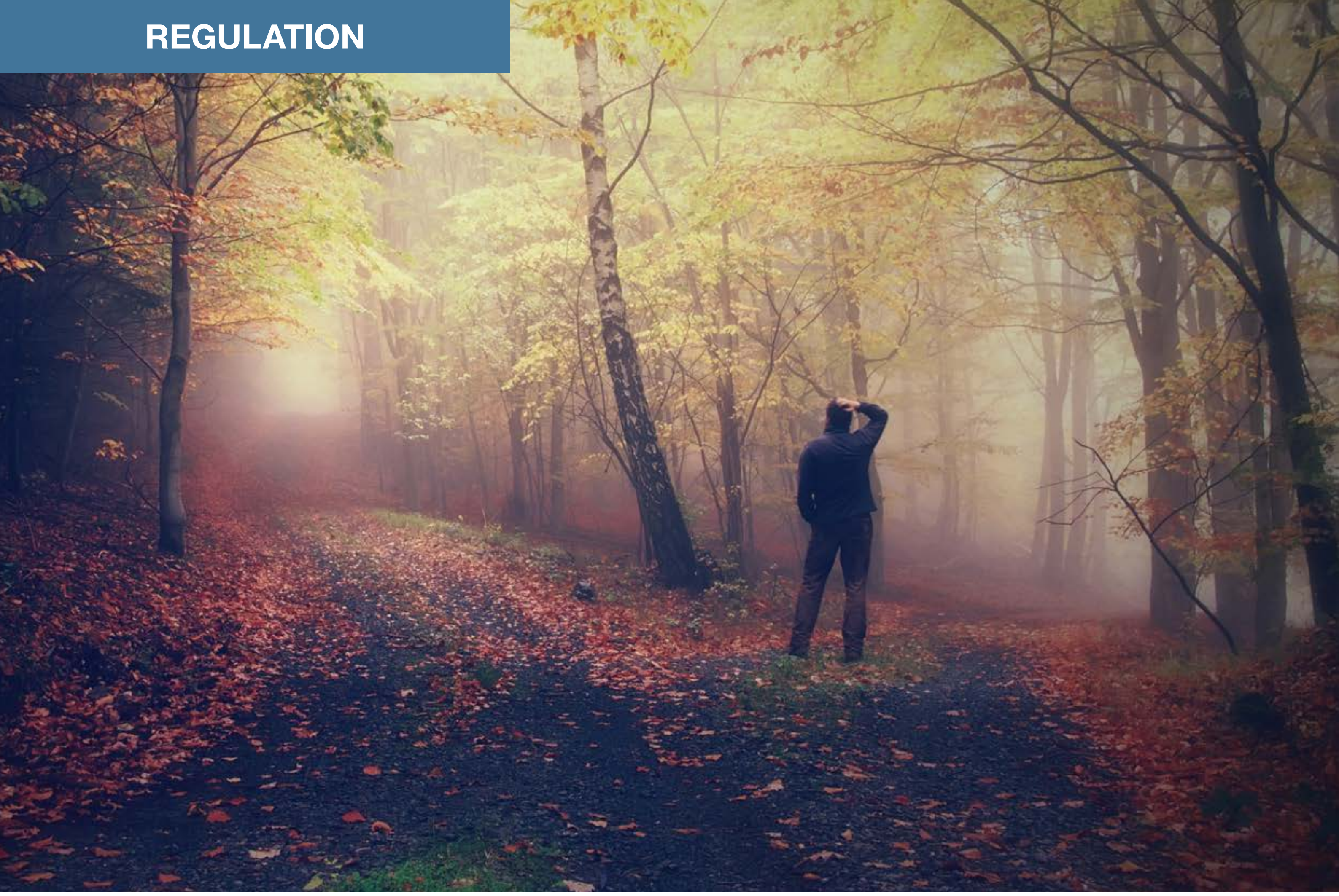
John Murray (Citi): I fully agree in terms of regulations, especially SEPA. Additionally, I think that corporates should be exploring what they can do with technology and how they can leverage it to become more efficient. An example here is SAP's Financial Services Network (FSN) and what that will enable in terms of connectivity, security and file format translation.

Neil Peacock (ABB): I will be well into our euro cash concentration project by the start of 2014, so this will be taking up most of my time. We will continue to focus on regulation – we have to be compliant and take advantage of compliance and the change it brings as well. It is pretty boring really and that is a good thing – more of the same.

Filipe Simão (BNP Paribas): You don't need a crystal ball to see that the main topic until early 2014 will be SEPA. But looking a bit beyond the SEPA end-date, we see interesting developments on the retail side, such as e-wallets, mobile acquiring – which will dramatically lower the entry barriers for small merchants – and tablet usage in corporate treasuries. A few of these solutions are already out there, offered by software vendors, payment providers and banks. Inevitably some will fail and some will thrive.

James Marshall (Virgin Media): When I gaze into my crystal ball, my challenge is to change from being a UK-centric cash manager into one that is part of a pan-European operation. Therefore I think it is going to be about the systems for us, to demonstrate a fit with our Liberty colleagues. This is something that we can take a lead on, as well as it being an interesting project for a treasurer to get involved with. The UK treasury team will not shoulder the burden of refinancing because this will be done by Liberty, so we can now turn our attention to supporting the business. Every time treasury assists the UK business, we add value through different payment types and modifying the business methodology.

Joy Macknight (Treasury Today): Many thanks to you all for participating.



MMFs regulations: is it too late to influence the outcome?

On 4th September, the European Commission (EC) released its long-awaited proposals for increasing money market fund (MMF) regulation. Just two weeks later, the Securities and Exchange Commission (SEC) closed its consultation with industry players. On both sides of the Atlantic, it appears that the writing is on the wall for constant net asset value (CNAV) funds.

Regulators internationally have been keen to increase control over money market funds (MMFs), which many consider to be part of the shadow banking system, since the financial crisis of 2007/8. The whole purpose is to address financial instability, and the proposals that have emerged from the Securities and Exchange Commission (SEC) earlier this year and more recently the European Commission (EC) must be put in the same context as the Liquidity Coverage Ratio (LCR) of Basel III, which puts constraints on banks to ensure that they adequately manage their liquidity.

However, now that both proposals are on the table, it is clear to see that these two jurisdictions are taking diverging paths to achieve the same end.

What has become clear is that the US regulators listened to the industry and have adopted an important second alternative to MMF reform. The SEC proposals tabled in June 2013 suggested two options:

1. Variable net asset value (VNAV): Investors will buy and sell shares using the actual net asset value, not a stable $1.00 share price. Fund managers all say this can only be done on a T+1 basis, which is a following day settlement.
2. Constant net asset value (CNAV): Fund managers may continue to provide CNAV funds providing there is provision for liquidity fees and the funds are permitted to impose redemption gates at times of stress.

This second alternative is a real breakthrough for the industry, following much more restrictive suggestions. Many in the industry credit lobbying and thoughtful briefing papers by HSBC as being the catalyst for this new alternative. Jonathan Curry, Global CIO Liquidity at HSBC Global Asset Management, who is also chair of the Europe-based International Money Market Funds Association (IMMFA), told Treasury Today: "We are pleased to see that the valuable part that liquidity fees can play in protecting investors and reducing 'run' risks has been recognised by the SEC as a potential part of the reform process in the US."

However, not all corporate treasurers are supportive of gates and fees. In a comment published on the SEC website, Gregg Murphey, Manager Global Treasury, Novelis Inc., argues that this proposal will "bring into question one of the greatest strengths of a prime MMF – liquidity". He goes on to say: "A fund who imposes a fee or withholds redemption would sink faster than a fund that breaks the buck under current regulations, which means the tool for the funds would be ineffective. In addition, cause runs could occur on funds, when news events about an issuer would cause holders to quickly sell their shares before everyone else does, trying to avoid the gate and or fee. In the current world, news events about individual issuers doesn't cause the level of panic that will be present when gates close and fees are imposed."

He believes that the proposed changes will discourage his company from participating in MMFs, and as a result funds will be smaller on an ongoing basis, "so it will be more likely that redemptions will push funds into a crisis position". David Dohnalek, Vice President of Finance and Treasurer, The Boeing Company, echoed Murphey's concerns in his contribution to the consultation process.

Meanwhile, back in Europe…

The news on the other side of the Atlantic is not as positive. EU legislators have, after extensive lobbying, adopted what are being described by the MMF industry as draconian rules. What you think of the rules depends on your perspective: finance ministers from France and Germany lobbied regulators to scrap CNAV funds, but there are many corporates who like the product and will be sorry to see it go. But go it will in its present form if the new EU regulation is adopted.

Whether or not the new legislation will get passed is where the industry is currently hanging its hopes. It is important to note that the regulation represents the EC's proposed initiating legislation and it must pass through the European law-making procedure involving the European Parliament and European Council before it can become new European law. This is likely to be delayed as a result of the European elections to be held in May next year.

Once in effect, funds must submit an application for authorisation as an MMF to their regulators within six months evidencing compliance with the regulation. The regulation is conceived as leaving no scope for additional 'gold-plating', or different implementation, at national levels.

Many in the industry hope that, as happened in the US, a change of political personnel will result in the proposed legislation losing its sponsors and fading away. They are also encouraged in this view since Paul Tucker, Deputy Governor at the Bank of England (BoE), who was a major advocate of stringent MMF reform, left the bank after failing to get the job as Governor. But it is far from clear why new regulators would back off from the proposed regulation. The proposals have been made with much references to public engagement and co-ordination with International Organisation of Securities Commissions (IOSCO), the Financial Stability Board (FSB) and the European Systemic Risk Board (ESRB).

There is also concern over regulatory arbitrage, but there are restrictions on Europe-based fund investors switching to US funds and issues about repatriation of funds becoming taxable in the US for US multinationals. In other words, some monies might find efficient ways to get into US funds but most will stay invested in Europe in some form. Going offshore (ex-EU) is not practical as the selling rules and regulations would preclude the funds being effectively sold to European investors. In addition companies are not likely to want to be seen investing in offshore locations which might lead to accusations of tax avoidance, whether justified or not.

In short, the European CNAV institutional MMF industry has a big problem on its hands. The Institutional Money Market Fund Association (IMMFA) has summarised the key issues, starting with what it describes as overarching issues.

Overarching issues

Three percent capital buffer

The current EC proposal is that each fund has a NAV buffer of at least 3% in cash. This is the single most important issue the industry has with the EU regulations. The idea that capital will be injected into funds in this way is a non-starter for some thinly-capitalised fund management companies – they simply do not have enough capital to be able to do this. Investment and commercial banks who have more capital believe that it is impossible to provide an adequate return on any capital that was so used. There is evidence to support this. Fund managers have been giving up or minimising fees to prevent the returns on funds going negative with short-term interest rates close to zero. It is hard to see how any the additional return required on capital could be earned.

IMMFA also makes the point that if the capital required (estimated at €14 billion) was withdrawn from the banking markets, it would, because of bank leverage, result in €200-250 billion being withdrawn from the European economy. Of course, it could be said that if the returns were adequate the capital would be found. The point is that insisting that CNAV funds have 3% capital destroys the business model and there is no evidence that we have seen to believe any fund provider believes it can do this and make anything like adequate returns.

Time for transition

The IMMFA then goes on to say that the implementation time for any changes set at six months is totally inadequate. Meanwhile, behind the scenes the mangers are looking at what is involved in moving to VNAV funds and what other options there might be.

Category A issues

The IMMFA then goes on to describe what it calls "Category A" issues.

Valuation – use of amortised cost accounting

The industry uses straight-line amortised cost accounting to value short-term investments. This is not mark-to-market, but the industry points out there is no liquid secondary market price for many short-term investments and thus no reliable pricing. Regulators want the industry to find a solution.

The IMMFA says: "In the absence of traded or quoted prices, amortised cost accounting is a pragmatic way to evaluate the fair value of money market instruments. Amortised cost accounting is widely used in the EU, is compliant with the Undertakings for Collective Investment in Transferable Securities (UCITS) and has been accepted by the Financial Accounting Standards Board (FASB) as being compliant with Generally Accepted Accounting Principles (GAAP). It is also used in the financial statements of banks to value loans and certain other assets. MMFs are not outliers in their use of amortised cost accounting."

Asset-backed commercial paper

The narrow description of 'securitisations' affects the funds' ability to invest in many types of asset-backed commercial paper (ABCP). IMMFA says this "has potential to hamper this funding stream to the wider economy". In practical terms, it also reduces the eligible investments managers would like to use in order to earn some slight additional yield.

Reverse repo collateral/diversification

The regulation proposes rules on what MMFs can invest in and what activities they can perform, restricting the type of collateral that can be used in reverse repurchase (repo) agreements and banning funds from engaging in certain securities financing transactions (SFTs).

Definition of liquidity requirements

Certain levels of daily/weekly liquidity are prescribed in order for funds to satisfy investor redemptions. CNAV funds will be obliged to hold at least 10% of their assets in instruments that mature on a daily basis and an additional 20% of assets that mature within a week.

Prescriptive credit process

The proposed regulation has set requirements for a consistent prescribed credit process across all funds designed to prevent credit arbitrage between the funds.

Ban on fund level ratings

Finally, there is an issue that will affect investors in particular – a ban of fund ratings by credit rating agencies. This will remove the AAA fund rating which is the cornerstone on which most investors base their investment policies. Fund managers expect this proposal in itself to lead to many investors walking away from this form of investment.

Other issues

The IMMFA then goes on to list other 'issues' which are as follows:

Application of the regulation

The way the regulation is worded potentially creates a higher risk of liability on the manager than any other type of investment product.

Valuation of assets

The regulation talks about assets being priced on the "more prudent side of bid and offer". The lack of a secondary market in many short-term securities which are all being held to maturity makes this impossible.

Eligible assets

Shares in MMFs are not themselves classifies as an eligible asset, thus preventing any master feeder structures.

Diversification

There is an inconsistency in the drafting that places limits on one type of investments and not another. In summary, it could be said the industry does not like the EC proposals.

Call to action

Lobbying is continuing apace, but it may be too late. The proposed regulation is not open to public consultation – yet many are attempting to influence regulators/legislators through diverse channels. For example, Richard Raeburn, Chair of the European Association of Corporate Treasurers (EACT), wrote a letter to the Financial Times on 6th September, calling into question the bar on the provision of external ratings. This stance was backed up by a letter from Mark Hannam, Independent Director at the IMMFA.

The IMMFA is working together with the Association of Corporate Treasurers (ACT) to ensure that the corporate voice is heard. Each member of the IMMFA will also be reaching out to its investors to get involved in the debate.

Susan Hindle Barone, Secretary General of IMMFA, recommends pointing out directly to local MEPs, as well as representatives from the BoE and the Treasury, how damaging these proposals could be. "We are encouraging anyone who cares about this to make their voices heard, whichever avenue that takes," she says. "We are trying to explain that this has a real impact on the broader economy and we struggle to get that message through."

The UK and Irish governments have been very vocal in their opposition to the proposed regulations. The French and German governments, on the other hand, support the legislation and want a ban on CNAV funds. Many German corporates invest in CNAV funds, whereas French corporates tend not to.

We live in an environment when regulation of the financial services industry is seen to be a good thing. It is hard to see why EU regulators would back away from legislation that has been proposed after 'extensive consultation' regardless of the consequences, both intended and unintended. One legal observer pondered that this was just an intermediate solution before a complete ban.

In the short term, CNAV funds will wait to see what the regulators do and, in the meantime, manage all the other challenges they are experiencing – low interest rates, flat yield curves and lack of short-term investments.

In the longer-term, the CNAV fund industry may disappear or shrink dramatically. In a subsequent article we will look at how VNAV funds might work in practice and what alternative forms of investment might startto find favour with corporate investors. ■

Karl Marx

"Let the ruling classes tremble at a Communistic revolution. The proletarians have nothing to lose but their chains. They have a world to win. Working men of all countries, unite!"

These are the closing lines to 'The Communist Manifesto' (1848), one of the better-known works of Karl Marx and close collaborator, Fredrick Engels. Although renowned as a revolutionary communist, Marx was also an eminent philosopher and economist, and is without a doubt the most influential socialist thinker to emerge in the 19th century. Marx's work in economics laid the basis for the current understanding of labour and its relation to capital, and has influenced much of subsequent economic thought.

As a result of the 2007/8 global financial crisis, many economists have revisited Marx's economic theory, in particular his theory of crisis. Marx believed that capitalism was a system of inherent and cyclic instability, driven by the tendency of the rate of profit to fall. In Volume III of 'Das Kapital', published posthumously in 1894, he wrote: "This mode of production produces a progressive relative decrease of the variable capital as compared to the constant capital, and consequently a continuously rising organic composition of the total capital. The immediate result of this is that the rate of surplus-value, at the same, or even a rising, degree of labour exploitation, is represented by a continually falling general rate of profit."

The falling profit rate hits the mass of profit, which causes a crisis of over-accumulation. The mass of profit at this point is insufficient to fund the next stage of capital investment, as the rate of return is insufficient to attract finance. As a result, capital seeks alternative outlets, and crisis and devaluation ensues.

"This is in every respect the most important law of modern political economy, and the most essential for understanding the most difficult relations. It is the most important law from the historical standpoint. It is a law which, despite its simplicity, has never before been grasped and, even less, consciously articulated," Marx wrote in 'Grundrisse' (1857).

In 'Das Kapital', Marx also wrote that companies' pursuit of profits and productivity would naturally lead them to need fewer and fewer workers, creating an "industrial reserve army" of the poor and unemployed: "Accumulation of wealth at one pole is, therefore, at the same time accumulation of misery." This has been used by a number of economists to explain the paradox of over-production and under-consumption.

"The more people are relegated to poverty, the less they will be able to consume all the goods and services companies produce," wrote George Magnus, Senior Economic Adviser at UBS, in a Sydney Morning Herald column in late August 2011. "When one company cuts costs to boost earnings, it's smart; but when they all do, they undermine the income formation and effective demand on which they rely for revenues and profits."

Nouriel Roubini, the New York University economics professor known on Wall Street as "Dr. Doom" because of his accurate prediction of the crisis, agrees that Marx wasn't "always wrong" about capitalism. In a blog entitled 'Is Capitalism Doomed?', which first appeared on Project Syndicate on 15th August 2011, Roubini wrote: "Karl Marx, it seems, was partly right in arguing that globalisation, financial intermediation run amok, and redistribution of income and wealth from labour to capital could lead capitalism to self-destruct (though his view that socialism would be better has proven wrong). Firms are cutting jobs because there is not enough final demand. But cutting jobs reduces labour income, increases inequality and reduces final demand."

Roubini's answer to the crisis is akin to Keynesianism, with government intervention through fiscal stimulus and stricter regulation of the financial system, as well as progressive taxation and investment in "human capital, skills, and social safety nets to increase productivity and enable workers to compete, be flexible and thrive in a globalised economy." However, Marx's answer was completely different. He argued for the complete overthrow of the capitalist system.

> "Karl Marx, it seems, was partly right in arguing that globalisation, financial intermediation run amok, and redistribution of income and wealth from labour to capital could lead capitalism to self-destruct."
>
> Nouriel Roubini

As Engels said, in his eulogy at Marx's funeral: "For Marx was before all else a revolutionist. His real mission in life was to contribute, in one way or another, to the overthrow of capitalist society and of the state institutions which it had brought into being, and to contribute to the liberation of the modern proletariat, which he was the first to make conscious of its own position and its needs, conscious of the conditions of its emancipation. Fighting was his element. And he fought with a passion, a tenacity and a success such as few could rival."

Early life

Karl Marx was born on 5th May 1818 in Trier in Western Germany, the son of a successful Jewish lawyer. He studied law in Bonn and Berlin, where he became interested in the philosophical ideas of Hegel and joined the Young Hegelians. In 1841, he received a Doctorate in Philosophy from the University of Jena, based on his doctoral thesis 'The

Difference between the Democritean and Epicurean Philosophy of Nature'.

In 1843, after a short spell as journalist/editor on a radical newspaper in Cologne, Marx moved to Paris and joined another leftist newspaper as co-editor. It was there he became a revolutionary communist and met Engels, his lifelong friend. He began refining his views on socialism based upon Hegelian and Feuerbachian ideas of dialectical materialism. According to Engels: "Proceeding from the Hegelian philosophy of law, Marx came to the conclusion that it was not the state, which Hegel had described as the "top of the edifice", but "civil society", which Hegel had regarded with disdain, that was the sphere in which a key to the understanding of the process of the historical development of mankind should be looked for."

> "For Marx was before all else a revolutionist. His real mission in life was to contribute, in one way or another, to the overthrow of capitalist society and of the state institutions which it had brought into being."
>
> Frederick Engels

By the spring of 1845, Marx's continued study of political economy, capital and capitalism had led him to the belief that the new political economic theory that he was espousing – scientific socialism – needed to be built on the base of a thoroughly developed materialistic view of the world. In 1848, on the eve of the French Revolution, Marx and Engels co-authored the pamphlet 'The Communist Manifesto', which asserted that all human history had been based on class struggles, but that these would ultimately disappear with the overthrow of capitalism by the working class to create a classless society.

In 1849, Marx moved to London, where he produced his magnum opus, 'Das Kapital'. The first volume, 'A Critique of Political Economy', was published in his lifetime, while the remaining two volumes were edited by Engels after his friend's death. Marx was a steadfast campaigner for socialism and was one of the founders of the International Workingmen's Association, also known as the First International, in 1864.

He died on 14th March 1883 and was buried at Highgate Cemetery in London. His tombstone bears two messages: "Workers of all lands unite", the final line of 'The Communist Manifesto', and "The philosophers have only interpreted the world in various ways – the point however is to change it", which is from the '11th Thesis on Feuerbach'. In his speech at the funeral, Engels referred to Marx as "the greatest living thinker, who has ceased to think".

'Das Kapital'

The first volume of 'Das Kapital', 'A Critique of Political Economy', was published in 1867 and analysed the capitalist process of production. According to Engels: "It is the first work in which the actual relations existing between capital and labour, in their classical form such as they have reached in England, are described in their entirety and in a clear and graphic fashion."

Volume I begins with an analysis of the idea of commodity production. A commodity is defined as a useful external object, produced for exchange on a market. Thus two necessary conditions for commodity production are the existence of a market, in which exchange can take place, and a social division of labour, in which different people produce different products, without which there would be no motivation for exchange.

"Marx suggests that commodities have both use-value and an exchange-value, initially to be understood as their price," writes Jonathan Wolff in 'The Stanford Encyclopaedia of Philosophy' (2011). "The exchange value can be seen in terms of the labour input required to produce the commodity, or rather, the socially necessary labour, which is labour exerted at the average level of intensity and productivity for that branch of activity within the economy. Thus the labour theory of value asserts that the value of a commodity is determined by the quantity of socially necessary labour time required to produce it."

Capitalism is distinctive, Marx argues, in that it involves not merely the exchange of commodities, but the advancement of capital, in the form of money, with the purpose of generating profit through the purchase of commodities and their transformation into other commodities which can command a higher price, and thus yield a profit.

According to Marx, profit is derived from the exploitation of the worker. In setting up conditions of production the capitalist purchases the worker's labour power – the ability to labour – for the day. The cost of labour power is determined in the same way as the cost of every other. "In this case the value of a day's labour power is the value of the commodities necessary to keep the worker alive for a day," explains Wolff. "If such commodities take four hours to produce, then the first four hours of the working day is spent on producing value equivalent to the value of the wages the worker will be paid. This is known as necessary labour. Any work the worker does above this is known as surplus labour, producing surplus value for the capitalist. Surplus value, according to Marx, is the source of all profit."

In Marx's analysis labour power is the only commodity which can produce more value than it is worth, and for this reason it is known as variable capital. As industry becomes more mechanised, using more constant capital and less variable capital, the rate of profit ought to fall. For as a proportion less capital will be advanced on labour, and only labour can create value.

In Volume II, he shifts his focus from the sphere of production of commodities to the sphere of circulation. Circulation is crucial to the expansion of capital, for it is only through sale of commodities that produced surplus-value is realised in the form of profit. By raising the issue of economic crisis at a number of points in the text, Marx underscores the problematic nature at the point of interface between capitalist production and exchange. In Volume III Marx makes the prediction that the rate of profit will fall over time, and this is one of the factors which leads to the downfall of capitalism. ■

With a little help from my friends

Anthony Fitzpatrick
Group Treasurer

CRH Group

Ireland's economy has been through the mill in the past few years but its corporate sector has learnt how to tackle the destructive effects of the financial crisis. Treasury Today talks to the Group Treasurer of the country's largest company about prospects for recovery and the power of knowledge.

Ireland's largest company, CRH Group, has navigated its way through some treacherous waters in recent times. But it is now on a more promising heading, not least because of the efforts of its own dedicated treasury team, led by Group Treasurer, Anthony Fitzgerald, and through the support of professional bodies such as the Irish Association of Corporate Treasurers (IACT).

CRH operates across Europe, the US, China and India and Fitzgerald has responsibility for both the formulation and implementation of CRH's worldwide treasury strategy and policies. From this perspective he observes an Irish corporate sector that is "trying to be as upbeat about the economy as possible". He notes that purchasing managers index (PMI) and gross domestic product (GDP) numbers over the past few weeks "are pointing towards green shoots of recovery". But, he adds, these shoots have been "threatening to bud" for the last three years, so it remains to be seen if that thread of optimism is misplaced: if definite growth is not yet apparent, the economy is not sliding backwards either which in itself is a positive that Fitzgerald sees as heralding a fundamental change in direction.

Beyond the general macro-economic concerns, Fitzgerald lines up three main treasury challenges. Many banks are still deleveraging, he notes, and the availability of credit is still tight and the SME sector has felt the lack of availability most. Even if a business overcomes this hurdle, cost of credit has also jumped significantly, he notes. "Up to 2008, bank credit was perceived to be a bottomless pit of cheap money that would always be available; that's no longer the case."

The impact of Basel III and the way banks manage risk is amplified by the fact that they can't tap the bond market as before, comments Fitzgerald. It is more expensive for a bank to fund itself and that cost is passed back into the corporate sector. Most strategic funding in Ireland (and much of Europe) has been sourced through the bank markets, with a smaller proportion of capital market or term-type funding, whereas in the US the focus is on longer-term funding. It is, notes Fitzgerald, another recent and significant change that more corporates are switching to the US model to gain stability.

In dealing with the issues that impact upon CRH's treasury, Fitzgerald quotes Sir Francis Bacon who wrote in 1597, "Knowledge is power". "Getting that knowledge by collecting relevant and timely information helps me to manage the treasury function within the business," he says. However, given the flood of information available today, a revision of Bacon's statement by 20th century American sociologist, Robert Staughton Lynd, is more apt: "knowledge is power only if man knows what facts not to bother with". For Fitzgerald, this is the art of treasury in the modern world. "There is a huge body of information available so it how you distil that down to what's relevant is the key."

Fitzgerald, who will be contributing to the end-of-day round-up panel of the IACT's (Irish Association of Corporate Treasurers) annual one-day Corporate Treasury & Cash Management Conference in Dublin on 20th November, is appreciative of the association's activities and initiatives over the years that have helped guide the profession in the most appropriate direction. "Many of these had been in place before the crisis started, but they have really come to the fore in the last few years," he notes.

Possibly the most pertinent for Irish corporates has been the regular seminars run around the country by IACT that touch on areas such as regulatory and accounting changes, investment and cash management strategies, benchmarking activities and even re-financing case studies. "They have all been very relevant," he states, adding that as well as "hitting the hot topics in Ireland" the events, which attract many of Ireland's treasury professionals, are a great place to "have a chat about the current issues we are tackling".

Green shoots or not, Fitzgerald says he is personally feeling more comfortable with the recovery in and beyond Ireland. "A lot of research I've read over the last couple of weeks suggests 2014 is going to be a good year and that we can draw a line under the last few years," he says. The Eurozone crisis is still a concern and, he adds, "we need to be able to draw a line under that too because it has dragged down consumer sentiment". However, he is looking to "a positive outcome" from the elections in Germany this month. This, he feels, will be important not just for Germany but for all Europe, "establishing the foundations for a more positive 2014 and beyond".

All together now: integrating payments, trade and working capital

The complexity of modern business means that a client and solution focused mindset is increasingly necessary to meet a corporate's daily transactional challenges. Integrated delivery, driven by this understanding, can help client organisations become more efficient in both their key business processes and in managing their finances.

For ING, Transaction Services has brought three distinct but closely allied product domains into a single line of business, as a third product pillar of Commercial Banking, alongside Financial Markets and Lending Services. Transaction Services merges the core flow businesses of Payments and Cash Management, Trade Finance Services and Working Capital Solutions, together with the highly specialised cash management and pooling business of Bank Mendes Gans. How does this approach influence ING's view of the world and more importantly, what does this mean for its clients?

The cash management challenge

It is no secret that as a result of the financial crisis, the professional view of treasury departments in companies has become even more important. However, treasurers also have a number of new important challenges to meet. Gerlach Jacobs, Global Head Transaction Services, ING Commercial Banking, immediately focuses on the growing pressure to optimise working capital management (WCM). "More than ever it is vital to combine the financial and the physical operational supply chain, and to become as efficient as possible in managing working capital, because during the crisis many corporates had to face reduced availability of bank credit."

Whilst Jacobs acknowledges that WCM continues to be a challenge, "because we are still living in difficult times and banks and the financial industry are still re-organising and responding to constantly changing regulation", he believes that the more a company treasurer focuses on managing working capital, the more efficient that business will become and the less dependent it will be on traditional forms of lending.

Working capital: staying focused

Of course, treasurers have always sought to manage their working capital; "it is part of their core remit", says Jacobs. But pre-crisis, when there was ample liquidity available in the market, it was natural for them to focus on other, more pressing issues. "Now we are in the midst of another difficult economic cycle and companies must once more look to improve all their financial metrics," he adds. And one way to do that is to ensure that their working capital is at peak efficiency.

It stands to reason that superior WCM improves key financial metrics including profitability, return on equity, risk perception and even access to funding. "What we see are companies focusing more and more on the different aspects of working capital – not just on cash and liquidity – and many are increasingly looking for tailor-made working capital solutions." Using products that are designed to enhance the working capital position of a company, corporates are looking at those parts of working capital which can generate optimal financing; Jacobs notes for example the increased appetite for payable solutions, with supply chain finance (SCF) in particular having "finally really come to the market".

It is easy to make bold statements of intent about improving WCM, perhaps by stretching payables or demanding quicker payment but Jacobs warns, it is essential to look deeper into commercial relationships across the physical supply chain than this would normally suggest. Corporates are focusing a lot on their core physical supply chain relationships but are so internally focused that it puts key suppliers under pressure. It is, he explains, vital to look at the right mix of products but also be very aware that the physical and the financial supply chain are very closely connected. "It is about making sure that you value your corporate supplier and buyer relationships, and ensuring that you have a good overview of your total supply chain and that it continues to work as optimally as possible. SCF is an obvious example where you can improve your working capital without creating a liquidity squeeze for your core suppliers."

Difficulties can arise if a business does not have oversight of all the different aspects of WCM, especially if there are competing metrics for each department involved in the overall process. Jacobs believes that part of the reason why corporate treasuries are more important is because the business units really need that overall view, now more than ever. Technology has a role to play in delivery, he notes, but reporting on working capital and on liquidity "is becoming increasingly professionalised" requiring a deep skill-set to correctly understand results.

There is also a need for ever more timely data, so that companies know exactly what their working capital and liquidity position is, on a real-time basis. "In some large corporates where all these activities were run completely separately, perhaps out of the accounts receivables (AR) or accounts payable (AP) departments, the quest now is for a more harmonised approach; it has to align because they all support each other."

But had there been a temptation to let WCM slip a little in times of easier credit? The focus may have shifted to other matters but Jacobs is adamant that treasurers have never "taken their eye off the ball". There is a constant demand for more up-to-date financial information, "and that is not going to change". Companies invest in technology, such as enterprise resource planning (ERP) systems, and that, he notes, is not going to change either. "All the measures that companies have taken to protect themselves against the financial crisis are going to continue and once they have started I do not think they are going to loosen their grip on WCM."

Working capital solutions

Supply chain finance: ING's SCF offering for suppliers and buyers combines outgoing payment services and a web-based portal. It features reconciliation functionality and full electronic trading of invoices. The ING concept aims to deliver a range of benefits to clients including access to transparent trade receivables and payables statuses and provision of automatic payments and faster funding. The bank's broad global network enables local supplier support during on-boarding, and its robust SCF legal structure is based on current best practice. In addition, ING's customised client support for programme rollouts can accelerate collaboration between finance, purchasing, sales and trade partners.

Factoring: As a cash flow tool, accounts receivable financing, also known as factoring, has a long history. Within ING it has been offered for more than 40 years as a means of raising working capital by financing their receivables, inventory and purchase orders. If a business is concerned with adding fixed costs, has slow turnover of receivables, is highly seasonal or challenged by lengthy manufacturing cycles (or is just undercapitalised), factoring may be used to accelerate the monitisation of receivables, improve cash flow and act as a risk management tool.

Trade receivables finance: The import and export business is full of financial and regulatory hurdles that can trip up the inexperienced. For clients who are looking to expand their export business ING provides its Trade Receivables Purchase Programme. An alternative solution to finance trade growth for exporting companies by purchasing large and diversified portfolios of their trade receivables. Customers generally have a focus on Europe, but are also active in the America's, Asia and the rest of the world, where they are supported by ING's local capabilities in 40 countries.

Cash and payments: SEPA is coming, ready or not

Another major cash management challenge for treasurers in Europe is the looming Single Euro Payments Area (SEPA) deadline. Jacobs believes that the whole industry still has reason to be concerned about its implementation. However, what he observes across ING's client base is a growing desire to move on, particularly as the 1st February 2014 deadline is almost here. Many large multinational corporations have made significant progress, "certainly in their SEPA Credit Transfer migration plans". On the SEPA Direct Debit side, he is less sure: "There still is a lot of work to do".

"We see regional differences. Some countries are more advanced in their implementation preparations than others and domestically I see smaller businesses still having many of their SEPA migration projects ahead of them," notes Jacobs. "There is no time to waste because the risk is that everyone waits until the last moment and then migration capacity is going to be under tremendous pressure."

Despite all the press coverage, alarm bells and the fact that governments are now helping to create more awareness across Europe on the importance of being SEPA-ready, the banking industry feeling is that "things could speed up a bit" on the corporate side. However, ING is "working day and night" to accomplish the migration. ING has many core corporate customers that need to migrate and Jacobs points to the various ways in which the bank is helping them to do that, including offering its expertise and guidance on formats, testing and customer on-boarding. "We have an army of SEPA migration project managers working with our clients, helping them to get ready for implementation," he says. ING also has a comprehensive website covering all aspects of SEPA preparation and migration at www.ingsepa.com.

Despite the pressure, ING believes that it is still feasible to have its client base ready for SEPA. Of course, payments are a network business and it is one thing to be ready yourself, but you are also dependent on all other entities with which you do business being ready too. Smaller banks and SMEs may not realise the implications of not being ready and, says Jacobs, it will be tough for them to comply. "This is the common theme in our payments industry and everyone is putting their maximum resources on this. Time will tell if all parties will be ready in time."

The inexorable move towards SEPA should be viewed as an opportunity for corporates to start considering the benefits it should bring. "At the moment that's not happening; people are just scrambling to make sure they are ready," notes Jacobs. Beyond February 2014, he suggests there will be a period "where we all catch our breath" and then the real opportunities will become more apparent. "Centralisation of liquidity is already possible, but I think centralisation of payments is the next step. We've always seen a delay in that for different reasons – too expensive, benefits outweigh the cost, and so on – but corporates are now going to look at these as real opportunities in SEPA phase 2.

Payments solutions: the Payments Factory

ING offers clients a centralised Payment Factory (PAF) which operates as an overlay service, providing a single-point-of-entry interface between the client's ERP system and the bank's infrastructure. PAF provides end-to-end connectivity with clearing systems and helps clients achieve uniformity in distribution channels, file formats and processes. Harmonising processes reduces or removes treasury duplication, increases oversight of local offices and can deliver savings through economies of scale and can be combined with a collection factory to optimise working capital management.

Developing trade finance

The likely impact of Basel III on some banking industry products is well publicised, including the possibility of increased costs for banks. In the trade finance space, there have also been some more positive effects of regulation, notes Jacobs. In certain markets, he says, some of the more stringent local regulations have eased slightly, as the regulators increasingly realise that the trade finance product set is fundamentally a safer product than some other forms of lending. Allied to this has also been a desire not to hamper trade by increasing the cost of a financial product that is a crucial "lubricant" in international trade. Jacobs is hopeful that this stance will continue.

Usually when costs rise due to increased regulation, the application of smarter product processing is often the solution. This can typically be implemented by either reducing processing costs by redesigning operations; or through more automation of business processes. "You would think that all that has been done, but there are still plenty of opportunities to centralise certain operations and create further economies of scale," he explains. "Most financial institutions are looking into their processes to make sure that their cost of doing business remains competitive."

In trade finance, this effort is nowhere better illustrated than by the advent of the Bank Payment Obligation (BPO). Although it has been around for a while, it gained a major boost in April this year when the International Chamber of Commerce (ICC) approved the uniform rules around the BPO (creating the URBPO). This, says Jacobs, goes a long way towards removing the process inefficiencies that are associated with paper-based letters of credit (LCs), whilst still retaining the desired level of risk mitigation to keep costs down.

Trade finance solutions

ING's trade finance products include letters of credit, documentary collections and bank guarantees. These can be combined and shaped into a custom-built solution, according to client need. With a letter of credit (also known as a documentary credit), the buyer's bank guarantees payment to the seller if certain criteria are met. Documentary collections, just as letters of credit, reduce the payment risks on international trade transactions, and with a bank guarantee obligations to third parties are ensured. All these products offer security and protection against risks if an international trade transaction does not go as planned.

Importers and exporters can also use a letter of credit to obtain financing. An exporter, for example, can obtain funding from its local bank to manufacture the goods as this bank is assured that payment will follow when the documents are presented under the credit.

The cash and trade alliance

Cash management and trade within the corporate space have always enjoyed something of a synergistic relationship, says Jacobs, noting too that "some of the products are substitutes for each other". However, in the current economic environment, corporates are increasingly sensitive to the positions of their core suppliers and the other key participants in their value chains. Therefore they are ensuring they use the appropriate products to cover their risks and to ensure that their entire value chain continues to work efficiently. "I think there's an even more proactive approach to make sure that there is access to sufficient liquidity throughout the entire supply chain" he states. "There is and always has been a close relationship between cash management and trade – and this will always be there."

An holistic approach

The corporates across the ING client base are, generally now much more interested in looking at an overall banking proposition, rather than taking a product-by-product view. "What I see is a more holistic approach, with corporates looking at their total value chain," Jacobs confirms. This holistic approach is driven by the need to make their working capital position as strong as possible, including reducing funding requirements and to become better at self-financing. It means that more functions are involved in the financial processes of the business, including IT and procurement, but this is a welcome broadening of the discussion. "In the past we talked mainly to the treasurer or assistant treasurer and the conversation was often about a specific product. Now we tend to meet with a larger group of client staff, looking at the company's overall financial position, how it all fits together and ultimately finding ways to improve working capital and liquidity."

Considering the increasing importance of the treasury department across ING's client base and the need for businesses to be on top of working capital more than ever, the bank has made some "quite dramatic changes" to its business model, says Jacobs.

It started by reviewing its core products; those seen as a key part of the working capital proposition for its corporate clients. It defined four overarching product domains: payments and cash management; working capital solutions; trade finance solutions; and a fourth product domain which is operated via ING subsidiary, Bank Mendes Gans, providing specialised overlay propositions (including cash pooling on a global basis handling close to 40 currencies). "I guess it's a sign of the times and also proof that companies are becoming better in managing their working capital, as we see that these products are in demand, with many customers having a growing interest in them," states Jacobs.

ING also created a client solutions group specialising in looking at the working capital of customers, coming up with "total solutions" (rather than focusing on a single product) to address the whole physical and financial supply chain of its customers. "We continue to develop our technology, investing in our portals, our centralised services for treasury and centralised data management," Jacobs states. "We are also looking at harmonising processes and our client service model. We are a large international bank with extensive market presence internationally but we want to make sure that our customers feel that we are a harmonised organisation, with all the efficiencies that a seamless consistent service can bring."

Keep delivering

Treasury presents a dynamic environment in which both corporates and banks must respond to and increasingly anticipate events. Right now, SEPA is top of mind and will stay there until at least 31st January next year. ING is mindful that it must give its clients time to implement and comply, but will also continue to work closely with clients to provide innovative solutions to improve their liquidity management. "Having gone through the SEPA implementation, in the second half of 2014 I expect many corporates will be seeking advice on what will happen in the post SEPA era – 'SEPA 2' – and how SEPA can improve their payments and cash management processes " Jacobs says.

The continual stream of regulatory change will absorb a lot of industry time and effort. The European Commission's proposal for a revised Payment Services Directive (PSDII), for example, was published in July 2013 and if approved by the European Parliament, will have to be transposed into law in each Member-state before being implemented. Such changes will continue to demand "a lot of the bank's attention" but, Jacobs adds: "We will continue to look outwards, servicing our customers and making sure that we continually make things easier for them and deliver the best solutions that fully meet their requirements – in the end this is what really matters to both us and to our clients."

Gerlach Jacobs

Global Head Transaction Services

ING

Gerlach Jacobs is Global Head Transaction Services at ING Commercial Banking since March 2011 and member of Commercial Banking's Executive Team. Jacobs held various positions within ING in Hong Kong, Los Angeles, Mexico City, New York, London and Amsterdam.

Transactions Services includes Payments and Cash Management, Trade Finance Services, Working Capital Solutions, as well as ING's specialised cash management subsidiary Bank Mendes Gans.

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Cause and FX

Stuart Kirk
Director of Global FX Risk Management

Stuart Kirk is Director, Global FX Risk Management, for Xerox. Having moved out of banking nearly a decade ago, he talks to Treasury Today about a whole new set of challenges and how Xerox has managed to square up to them with a lot of judgement and a little luck.

Xerox, like Hoover, Aspirin and Escalator, is one of those companies whose names have become synonymous with an entire genre: in this case, photocopying. Consistently creative Xerox, founded in the US in 1906, has ideas far beyond being a noun and a verb. Company Chairman and CEO, Ursula Burns, now presides over a business that has sought to escape the curse of a generic trademark. "From our earliest days, our purpose was never about making copies but making it easier to share information," she said recently.

True to this cause, in 2010, Xerox took a greater step forward, acquiring business process outsourcing and information technology services provider, Affiliated Computer Services (ACS). The combined business now has operations in 160 countries, employs more than 140,000 people and offers perhaps the broadest portfolio of document management, business process services and software in the world. In 2012 the business generated revenues in excess of $22 billion.

Xerox may be a single-minded company in terms of how it gets things done, but it is formed of two distinct sides. It has a technology business, offering printing and document handling functions; and a services business which covers a broad sweep largely around the business process outsourcing space. Its treasury operations are divided between two key locations: Norwalk in Connecticut, US and Dublin, Ireland. Strategic decisions flow from the group treasurer's office in the US whilst responsibilities within the Dublin office are divided between global foreign exchange (FX) risk management and cash and liquidity management (with a team of five treasury-dedicated accountants to boot) with both joining forces to manage the inter-company loan books and the balance sheet management process that sees cash from all entities pooled for central deployment (more of which later).

The Dublin-based treasury serves almost all operations outside of the Americas, covering Europe, across to the Middle East and India and into parts of Asia Pacific; the majority of the latter, at least on the technology side, is managed by the long-established Fuji Xerox joint venture.

> "We're not at the point of putting an overlay structure in place yet, but that's where I'd like to get to."

Xerox is naturally dollar-denominated but like many MNC's, it has several treasury companies to meet localised funding needs. This structure gives Xerox a multi-currency balance sheet, centrally-managed from Dublin. A major part of this office's remit is to manage the currency risk attached to the balance sheets of all the treasury companies.

Within the business operations, currency exposures are centralised and managed in as few locations as possible (eg supply centres), whilst within the emerging markets, where rules vary widely, exposures are managed country by country. All this activity certainly places a heavy demand for all the major global currencies, with 37 different currencies in the current line-up. A multi-billion dollar total FX trade flow is generated by around 6,000 deals per year.

Then and now

Heading up the FX risk team is Director of Global FX Risk Management, Stuart Kirk. Kirk started his financial career as a management trainee on the retail side of Ulster Bank. He swiftly moved into the treasury team and took on FX trading duties before moving to Citibank in Dublin as a proprietary trader. When Citi closed the desk as part of its centralisation programme, Kirk transferred to Bank of Ireland Global Markets as Senior Dealer for Spot FX ("watching over the demise of the Irish pound") before getting into his current professional stride, setting up from scratch the treasury operations for Gensec Bank Ireland. Gensec was the overseas investment banking arm of South African insurance company, Sanlam. Sanlam later decided to exit banking altogether, by winding up Gensec Bank and selling its 25% shareholding in ABSA to Barclays.

As that door closed, another opened with the chance meeting with a former Citi colleague who had recently returned to Ireland after a stint with Xerox in the US to head up the Dublin treasury centre. Under the guidance of the firm's new group treasurer, Rhonda Seegal, they decided to set up a centralised FX risk management function in Dublin. With the new office in need of FX risk expertise, Kirk stepped into the breach, once more charged with setting up operations from scratch, commencing in January 2004 as Director, EMEA Treasury. He held this post for five years before rising to his current position of Director, Global FX Risk Management.

Now, working alongside the US-based Directors of Global Cash Management and Global Corporate Finance what exists, says Kirk, is an "extremely well joined up" operation. This, he adds, is a product of the group treasurer's vision of unity across the Treasury function.

And the winner is…

En route, Kirk joined the Board of The Irish Association of Corporate Treasurers, a position he held from 2005 until 2011, taking up the reins as President in 2009. Together with many of his co-workers at Xerox, he has also earned a Yellow Belt for Lean Six Sigma business processes, a methodology, he feels, "makes you terribly disciplined about how you approach things".

It was this quest for clarity and order that saw Kirk collecting the most recent feather in his treasury cap. His effort to put in place a new approach to currency risk management was feted in June of this year as winner of the Best Foreign Exchange Solution at Treasury Today's Adam Smith Awards. The system, explained below, has seen currency risk management edge closer to centre-stage with some significant benefits brought to the group.

Treasury drivers: the in-house bank

Embedded within the global structure of Xerox are over 250 operational entities which sell equipment and services to clients across the world. Alongside these are a number of shared service centres (SSCs) including sites in India, the Philippines, Malaysia, Ghana, Guatemala, Jamaica, Mexico and Peru. Wherever possible all short and longer-term lending and project-based finance is funded from Dublin. Similarly all surplus cash is remitted to Treasury (preferably on a zero-balance basis)

With all banking, funding, liquidity and corporate finance functions under one roof, the Treasury is effectively Xerox's in-house bank. It works directly with a small group of global cash management banks which provide "the plumbing" that enable cash transfers in and out. Typically, Xerox entities around the world do not borrow from or maintain deposits with local banks and only require bank accounts to pay local bills, salaries and so on and to facilitate sweeping.

If an entity needs cash for non-routine purposes – funding for an infrastructure project to enable it work with a new client, for example – it can call upon Dublin to provide that loan efficiently and without prejudice. Indeed, as an in-house bank, Dublin relies on each entity to inform it of its needs and, as long as it has business approval, treasury does not veto these funding requests (as a 'real' bank may do). That said, treasury is "not an ATM machine that dispenses cash automatically", states Kirk. In fact it is involved closely in processes such as the structuring of funding, asset and liability management, and taxation, legal and accounting matters. This ensures each entity is set up optimally in terms of the amount and type of capital and debt on its books.

The industry model today veers more to clients leasing rather than buying equipment outright (a business model actually invented by Xerox in 1959 to promote its Model 914 copier). The recent shift further in this direction has seen the company establish leasing companies in most countries around the world. These are able to borrow term funds from treasury (from three months up to five years, depending on the size of the business) to match the portfolio of leases to external clients, the basis risk thus transferring to the centre.

A new way of hedging

Xerox's award-winning currency risk approach is described by Kirk as an "evolving process", growing out of the implementation of a new treasury management system (SunGard's Quantum) back in 2004. Having aligned its business processes to match the system rather than the other way round, as had been the case with the previous system, the company could enjoy straight through processing for the first time. With everything transaction-driven and online, loans, deposits, FX trades, risk limits, bank account data *et al* could be booked in Quantum, enabling accounting processes to run straight from its general ledger. Automation also meant that spreadsheets could be retired and, bar use for ad hoc analysis, most have now gone.

> "We're not trying to make money out of currency. What we're trying to do is dampen down the impact of currency volatility."

Having built the foundations for progress, the first task of the new FX risk management regime was to look at group exposures on a consolidated basis and to quantify the total impact of FX volatility on earnings. The second was to tackle transparency around Xerox's existing hedging programme to optimise and balance cost with risk. The final part was to find a more systematic approach to FX hedging.

Kirk explains that Xerox's policy is for 100% of on-balance sheet exposures to be hedged, but a variable percentage applies to forecast exposures; the more certainty underpinning a forecast, the higher the ratio hedged and vice versa. Some of Xerox's currency exposures are naturally more certain than others. Its Yen exposure, for example, has a higher degree of certainty than other currencies because the volume of trade with the company's Japanese suppliers is fairly consistent. Some uncertainty remains and thus how far out to hedge, when, and with what product, is a primary concern.

The development of a systematic hedging process saw the team consider a number of possibilities. Hedging a whole year in advance at one time was deemed too risky. A rolling programme was considered, where every quarter a certain percentage of a currency requirement is hedged 12 months out, but often this would achieve little more than the average forward rate. It was decided that where forward contracts were not adding value, the focus should shift to FX options.

DLH arrives

With banking partner Citi, Xerox turned to the concept of relative value. Here, if the price of a currency is above its long-term fair value, then forwards should be used. If the price is more or less par with fair value, a mix of forwards and options should be used. If price is way below fair value, the approach would be to use options (on the basis that price should revert to fair value over time). At different points in the cycle all of these products can be used in varying degrees, hence the process is known as Dynamic Layered Hedging (DLH).

"What we're doing is assessing where the price is, relative to fair value and where we are in the business cycle," explains Kirk. Keeping track of each layer in each quarter over a rolling period of four or five quarters requires the fine-tuning of each layer and taking product decisions every quarter; it is complex, he admits, but it yields results – and in any case "the power of technology" is at hand.

The genesis of the DLH lies in an enormous amount of back-testing with Citi that used data accumulated over 20 years. This exhaustive technology-led process enabled Xerox to move ever-closer to the most appropriate blend of products and scenarios based on its core currency exposures. Having now successfully run DLH for three years, even some of the non-core currencies are now being brought into the programme. However, Kirk points out that hedging emerging market currencies can be prohibitively expensive and only a "slimmed down" version of DLH can be deployed, if at all.

The next phase of the hedging programme will be to advance scenario testing beyond the current currency-by-currency or country-by-country basis towards a total-corporation basis, enabling Kirk to plot against more detailed trends. Correlation analysis between currency pairs has already been undertaken using the risk module within Quantum (the system underwent a major upgrade in 2012). Kirk's goal is to be able to feed all exposures into a single matrix so the impact of any movement by any currency can be monitored and, as a dollar-reporting company, any translation risk faced by Xerox can be tracked. "We're not at the point of putting an overlay structure in place yet, but that's where I'd like to get to."

Treasury evolution

A broader understanding of FX risk around the business has also helped steer it in the right direction. "As I've engaged more with the business over the years, more people realise how currency can affect our business," Kirk notes. "They never used to think about it; it was just something treasury took care of." Now, he says, it's got to the point where almost everyone has a view on currency which is not always a good thing: "sometimes it feels like I'm surrounded by currency experts!" Hence the company has had to adopt a more systematic approach "to take the emotion out of the hedging decision".

As treasury professionals obviously fully in-tune with the potential consequences of currency movements, Kirk and his team has a well-rounded (and well-grounded) remit. "We're not trying to make money out of currency. What we're trying to do is dampen down the impact of currency volatility, period over period." It's a demanding role, but that is what Kirk seeks. There have been some significant external changes which have been implemented over the years and now, with the likes of SEPA, Dodd-Frank and EMIR, and the indirect impact of Basel III to contend with, he relishes the next set of challenges in his career. The move away from banking (an industry which is now extremely challenging "for all the wrong reasons"), comes with no regrets. For Kirk, "being part of a highly-rated global company is where the action is now". ■

Key trends in cash and trade

Interesting times lay ahead for the transaction services industry and providers have to deliver on many fronts. Without doubt, the quality of the relationship and the insight provided by banks around the converging themes of cash and trade continue to offer a vital lifeline for corporates the world over. Anand Pande, Global Head of Trade, and Steve Everett, Global Head of Cash Management, discuss the depth and breadth of transaction services capabilities at RBS.

Regulatory changes and a low-yield environment are just two of the major factors that continue to affect transaction banking in both the cash and trade functions.

From a cash perspective, Steve Everett, RBS's Global Head of Cash Management, notes that many corporates are long on liquidity and must find ways to safely look after their cash – a topic which has been at the forefront of the agenda throughout the financial crisis – and manage counterparty risk and exposure to financial institutions. He states that "in almost all markets, interest rates have decreased over the last five years – none more so than in euro, dollar and sterling, which are the principal currencies in which our clients hold liquidity."

This has left many corporates severely challenged in terms of looking for yield but, notes Everett, "few treasurers will trade safety for yield. This is where the large global transaction banks, such as RBS, can help." With a well-developed product suite, RBS enables treasurers to have access to liquidity as and when they need it in the event of counterparty challenges, whilst benefitting from an improved yield, when they don't.

Regulation

Globally, banks are continuing to face increased regulatory pressure. "We're seeing new regulation from the US, Europe and the UK, as well as from some of the Asian markets," says Everett. This regulatory influx, he observes, is shaping how banks work with their corporate clients, particularly in terms of helping them to understand precisely what that regulation means to them.

On the global stage, the impact of regulation on banks is clear, but there is a knock-on effect for clients. With Basel III, for example, the liquidity constraints that regulators are placing onto banks may change the dynamic of the deposits a bank can afford to take. "There are some unintended consequences," admits Everett.

The Single European Payments Area (SEPA) is also front of mind. "We have a large client base that is either based in Europe or doing business in Europe. They all need to ensure that by 1st February 2014 they are compliant with the regulation," adds Everett. This is clearly absorbing a lot of corporate time and effort.

Local knowledge

As many corporates operate in the global arena, they are increasingly looking for banking partners with not only a global perspective, but also local and regional knowledge. Everett observes that, certainly on the cash and liquidity side, many businesses have stepped away from one global partner that does everything. Now, Everett notes, many seek regional expertise and are prepared to use several banks to get it.

"And this is where the strength of RBS can benefit clients; our presence in 37 countries is critical. You cannot get that local knowledge without having people on the ground who understand what is happening in a particular country or hub, whether in South-East Asia, Central and Eastern Europe or the Middle East. Maintaining that local presence is something we are committed to."

Cash support and SEPA

Is the pressure on the modern treasurer too much to bear? "I think they've come through all of the uncertainty of the financial crisis in terms of understanding their cash position," asserts Everett. However, he warns that treasurers should never lose sight of this and "one should never get too comfortable; the last thing you want is to get into new trapped cash scenarios, as market dynamics change."

Indeed, Everett believes that "visibility of cash remains king." Corporates are generally sitting on a lot of liquidity, but they need to know where it is, so that they can direct it to safe havens, if needs be. "And that's where our liquidity management solutions come in to play and why we have extended our pooling, sweeping and investment products into Asia over the last 12 to 18 months," he explains. Unless they have specific trapped cash issues, RBS's corporate clients based in the US, Asia or Europe can "pretty much manage to get cash into the right location on a daily basis and that, first and foremost, ensures its preservation."

RBS SEPA Accelerator

However, one potential source of concern is the number of corporates still struggling to meet the SEPA deadline. RBS, as a major mover of euros, has developed a solution – the award-winning[1] SEPA Accelerator. With SEPA Credit Transfers (SCTs), the payment must be formatted using the ISO 200022 XML format. "A number of corporates still need to change the way that their payment instructions leave their ERP systems, to enable them to get into the clearing systems," notes Everett. "Success is all about knowing detail such as the Bank Identifier Code (BIC) and International Bank Account Number (IBAN) of the ultimate beneficiary; for a large corporate this can be a huge undertaking but this new solution can do the work for them."

For SEPA Direct Debits (SDDs), there is a change in the way that mandates are managed and the type of information that the client needs to hold. SEPA Accelerator offers an enrichment service of the legacy mandate and mandate management that ensures everything is compliant, so clients can continue to collect funds in the usual way. This gives them certainty around their cash management and cash flow forecasting. "It's very much a backstop solution for clients that are not ready to be fully SEPA compliant."

Through the creation of a new SEPA microsite, RBS has been able to share insight with corporates, that helps them to understand the implications of SEPA, what they need to do and importantly, says Everett, "what RBS can do on their behalf or in partnership with them."

GlobalXChange™

GlobalXChange™ is an RBS umbrella brand for a number of products that feature a foreign exchange (FX) conversion path. It enables clients to have greater transparency around FX rates that are being applied to their transactions, whilst improving operational efficiency. "Five years ago, the key focus was on managing cash across multiple accounts and how to bring those balances together to leverage that liquidity," states Everett. "Today, corporates don't want to have multiple accounts spread across a wide network, because it's operationally inefficient and results in numerous auditing and accounting challenges."

Increasingly, he sees treasurers using one account to make multiple payments in multiple currencies. RBS can extend the reach of the high and low value payments that they can make, in up to 140 currencies for corporates and FIs – via one account, in the client's base currency. Clients can send RBS a batch of payments and the bank will translate them, manage the FX risk and send them out through a single account, without the client having to open up a currency account in each location where it wants to pay a beneficiary.

Trade finance trends

"I think everyone is trying to keep their heads above water," comments Anand Pande, RBS's Global Head of Trade. For Pande, the current environment presents quite a different world, where a bank has to look at conflicting objectives, while ensuring it continues to be relevant to its clients. The ideal paradigm is one where businesses can simultaneously increase revenues, reduce costs and optimise capital. But delivering this in a world which is slowing down is a tall order. Indeed, recent global trade figures indicate growth of just 2%, whereas two years ago it was more like 10%. "Clearly there is a big slowdown," states Pande. The emerging market sector was supposed to be the saviour but even this has been unsettled, as we have seen with recent events. And on top of this, there is the risk to the financial health of overleveraged organisations in an environment where growth is slowing down and margins are compressed. Hence, the profitability of these organisations is under increasing pressure."

Pande believes that RBS's dominance in supply chain financing (SCF) "is a key strength" for clients seeking this paradigm. Whilst SCF has "still not reached maturity level", it is developing in the right direction: RBS's own SCF book has grown by 42% in recent years. "The traditional attraction," he says, "is access to cheaper funding options for suppliers, backed by the stronger credit standing of the buyer." Depending upon the liquidity options required by the buyers, they can also consider extended payment terms from their banks, while ensuring timely payments are made to their suppliers. But the concept is evolving and newer models are being considered where, for example, the discount level is based on the timing of the payment, and also on the alignment of electronic invoicing (e-invoicing) with SCF, helping to streamline the process.

Part of the solution lies in giving customers a choice in terms of how they transact with the bank. Presented with the option of proprietary bank software, SWIFT or third-party systems, clients can choose the most optimal solution for them to gain increased back office efficiencies. Says Pande, "RBS is one of a small number of banks which has an open highway, in terms of connectivity."

The trade function is no stranger to regulation either. States Pande, "This is where we can play a key advisory role, because everyone is now searching for growth from new markets.

New trade corridors means ensuring growth occurs with adequate advice on risk mitigation tools, as well as with proper regulatory conformance. This is an area where leveraging the scale of the RBS network can be extremely beneficial to our customers."

Trade concerns

"One of the main issues for treasurers on the trade side is how to achieve an optimum balance between growth, liquidity and leverage," says Pande. In achieving this balance, the RBS network plays an important role in helping clients understand local markets. The bank also helps clients with their cross-border growth aspirations, by acting for OECD domiciled corporations as the trade bridge into and out of Asia. "RBS provides a range of tools to help corporate expansion plans, both pre and post acquisition, and works closely with the extended business thereafter, through its local country network".

[1]The Banker Transaction Services and Technology award for innovation in wholesale payments 2013

RBS draws upon the skill set of its trade asset management and distribution team to help manage risk, so that the bank can give clients more balance sheet and hence become more relevant to them. At the same time, the bank distributes and sells down exposures to investors "who want to have access to high quality trade assets."

"People often think of trade as simply intermediating cross-border flows, but trade is not only about import/export; it is also about the domestic market. Indeed, more than 50% of the GDP of most significant trade nations is domestic," Pande says. "Having people on the ground who understand the local market, and can offer solutions to help companies grow and expand their business domestically, becomes an important differentiator."

The effects of Basel III on trade

"With the current state of play, more capital is now required for the same amount of trade," notes Pande. "If margins are going south, then clearly trade is going to suffer." He feels banks have to collectively impress upon the regulators that trade business comprises of short term self liquidating transactions and hence has to receive the right capital treatment. In this respect, some progress has been made.

But banks also have to work with corporates to remove under-used credit lines. Says Pande, "If your credit lines are not utilised there is still a cost in terms of capital; we need to optimise credit lines and get rid of the excess." The requirements of Basel III will make the world a better place, but it is also vital to achieve the right treatment for trade, otherwise I think the trade finance business is going to be under tremendous stress".

Forging the BPO

"For some, the Bank Payment Obligation (BPO) is a development that uniquely offers risk mitigation in the otherwise trust-based open accounts space," explains Pande. "BPO will thus help energise global trade." RBS, as one of the four banks which helped draft the Uniform Rules for Bank Payment Obligation (URBPO), is committed to the concept. However, Pande believes that BPO has a long way to go before it becomes scalable, as it cannot be a push from the banks, but needs to be a pull from the corporates.

For this to happen, banks will have to invest time in educating corporates – "and then there are practical considerations," notes Pande. BPO involves the electronic matching of data. Banks should be able to receive data electronically from the corporates and convert it, to enable straight through processing (STP). A plug-and-play format between corporates and banks to send and receive data will help in increasing adoption rates.

Corporates also deal with large and small banks – often across multiple geographies. "There is a need to on board the small banks," Pande says, "but the cost of implementation for them may not be palatable. I don't see that happening soon, it's a medium-term option," he suggests. "However, if we get these things right, then BPO is going to be a huge success story."

The rise of RMB

"With the progressive internationalisation of renminbi (RMB) in terms of trade settlement, there are certain areas where the currency is gaining much traction, says Pande. "If you look at Hong Kong and China, the settlement in RMB between these markets is dominant. The RMB at the moment has climbed from being ranked 20th as an international currency at the end of 2011, to 11 in 2013. The growth in RMB settlements has been fast and accounts for 15% of the China trade. These trends are positive and in time, we would expect to see RMB continuing its journey, to become one of the major trade settlement currencies."

RBS is investing in its product set around this industry development and in terms of the offshore RMB, the bank is now opening up accounts in Western Europe, explains Everett. The bank is looking to include these accounts in cash concentration liquidity pooling solutions and is also working with other industry players to look at how the UK can establish itself as an offshore clearing hub in a similar way to Hong Kong. "As an international bank, we are aiming to be a leader in this field, particularly in Western Europe, as corporates become more aware of the opportunities around RMB."

Maximising corporate growth potential in Asia

Intra-Asia trade accounts for around 60% of all Asian trade flows for which RBS has local currency products. But as additional new trade corridors open up, including those to Latin America and Africa, it is predicted that eight of the top 20 trade partnerships will be ex-Asia. At an estimated value of around $2 trillion by the end of 2030, this will drive the shift in emphasis from West to East. "With excess liquidity within Asian corporates, we are seeing an increase in acquisitive trends, notably with Chinese, Indian, Thai and Indonesian companies – and banks have to facilitate that," notes Pande, adding that "companies will face a big problem in the future, if they exclude Asia from today's planning."

Cash and trade as one

Intuitively, observes Everett, "trade and cash have to come together at some point because companies need to maximise the use and forecasting of their cash" – and a key focus will be around SCF and FX. To this end, RBS is moving to position both elements as a joined-up proposition. He sees niche opportunities opening up already. In the US for example, by using an Earnings Credit Rate product, if a client is willing to place deposits with RBS, the bank can use the nominal interest that it would pay on that to offset some of the client's banking fees; often these are trade-related. "That can give the client a good offset between revenue and cost in its financial performance".

The benefits of bringing trade and cash together across multiple localities is abundantly clear. But, says Everett, "if you are going to do it, and do it well, you need to be on the ground; that's where the RBS network is leading the way". Many banks talk about partnering but, he states, "nothing beats actually having a physical presence – in terms of the people, buildings and technology, which underpins the ability to link directly into the local market".

In the end, for Pande, it boils down to "the real old fashioned approach of thinking about how we can make the life of the customer simpler". And that, he says, is where RBS excels. "A bank may claim the best technology and the best products, but it is equally important to have that softer people side and the ability to form partnerships."

Anand Pande
Global Head of Trade

As the Global Head of Trade, Anand Pande is responsible for driving the development and growth of RBS's trade finance business globally. This covers all products from traditional trade services and finance to commodity and supply chain financing solutions across more than 35 countries. Pande was recently honoured by the Asset Asian Awards 2013 as the Trade Finance Banker of the Year.

Steve Everett
Global Head of Cash Management

As the Global Head of Cash Management, Steve Everett is responsible for developing and promoting RBS's market-leading, innovative cash management solutions with product specialists across the world. Previously he was Global Head of I-LIM and FX, responsible for delivering the overall Liquidity and FX proposition for the transaction bank.

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Escaping the cash trap

Asia's strict regulatory environment has long been a problem for corporate treasurers seeking to optimise their group's liquidity in the region. But with the pace of regulatory liberalisation increasing, the situation is improving. This article looks at some of the new options available to corporate treasurers trying to tackle the problem.

China is regarded as both the most important and most restrictive market in terms of liquidity management, but this is changing. A few years ago, the options for multinational companies (MNCs) in China wishing to repatriate excess liquidity were limited. Due to various restrictions on renminbi (RMB) conversion imposed by the People's Bank of China (PBoC), companies could either release their trapped cash through dividend, royalty or service payments – which all have withholding tax implications – or through entrustment loans.

But there has been much change since then. Regulatory reforms are easing the cross-border flow of funds and helping companies to strengthen their liquidity management across the whole business.

In line with its long-term objective of improving the convertibility of RMB, the PBoC has relaxed controls on cross-border RMB flows through the introduction of schemes for inter-company lending, in both RMB and foreign currencies, and cross-border netting. Companies are now taking full advantage of the new rules. In early September, Kunshan President Enterprises Food Company Limited successfully completed a two-way cross-border RMB lending transaction. A few days before, Coca-Cola Beverages in Shanghai announced it had made an RMB250m ($40.85m) inter-company loan to a London-based subsidiary.

Incremental reforms are also taking place in other historically restrictive Asian markets. In Malaysia, for example, the capital account restrictions introduced in the wake of the 1997 Asian financial crisis are now being lifted.

India, meanwhile, is now permitting companies to perform lending transactions to their overseas subsidiaries – providing, that is, the transactions do not exceed 400% of the company's net worth.

The trend towards deregulation is an important development for corporates that are holding onto historically high levels of cash. Apple, for example, has built up over $100 billion in excess cash, albeit not all of it is sitting in Asia. Liquidity security is of primary concern for corporates following the financial crisis, which means that cash accumulation and deployment has become their biggest burden.

Cash management in a changing region

Companies are increasingly taking a global approach to liquidity management and want not just visibility and control but, most importantly, access to their cash. They need to be able to consolidate their cash and get their hands on it quickly. The problem is keeping up with the rules in all the countries that a company operates in.

Understanding just how to navigate these rapidly changing regulatory environments is crucial for companies wishing to take advantage of the new opportunities springing up in China and elsewhere, according to Andrew Ong, Asia Head of Liquidity Management at Bank of America Merrill Lynch (BofAML). Banks can help their clients navigate this complexity.

"For companies in Asia, a solid banking relationship characterised by local expertise, product innovation and global platforms is absolutely essential for unlocking trapped cash," he says. "Corporations need to be confident that the organisations they bank with maintain strong relationships with local regulators, and are able to help them understand how and why policy is changing."

Thomas Schickler, Global Head of Liquidity and Investment Products for HSBC's Global Payments and Cash Management Business, agrees that a close banking relationship will be important to companies as the region continues to develop new rules. "We work very closely with our clients to help them to understand the direction of the regulations, plan for how this can impact the way they manage their liquidity and, where relevant, guide them through the process to seek the necessary regulatory approvals. At HSBC, we maintain relationships with regulators at all levels and participate in discussions with them about how the pilots should proceed, including the implications thereof for all of the concerned parties: regulators, banks and corporates."

Due to the potential impact of Basel III on the availability of bank funding and the prospective higher cost thereof, corporates have heightened their focus on identifying diverse sources of liquidity. In a shift from legacy practices, in which liquidity was managed on a regional or single currency basis, treasurers are now focused on globalising their approach to liquidity management, says Schickler.

To that end, they are increasingly willing to trade off operational efficiency in order to be able to maximise the centralisation of their liquidity. "When treasurers look at the situation – particularly at the excess cash which is available to them in markets such as China, and even Indonesia and the Philippines – they will accept a more operational approach to tap the material excess liquidity that otherwise would have remained isolated."

But there is a caveat to cross-border lending which treasurers need to be aware of, says Ong. Companies participating in the schemes are still subject to existing foreign debt quotas. This can be executed by establishing a new foreign currency international header account in a cross-border foreign currency sweep structure, thereby limiting all foreign currency

Key steps to unlocking your trapped cash

Drawing on his 17 years of experience working in treasury and cash management in the Asia Pacific region, ANZ's Global Head of Liquidity Management at ANZ Transaction Banking, Philippe Jaccard, shares with Treasury Today his top tips for managing trapped cash in the region's tightly regulated markets.

1. Do not underestimate the importance of cash flow forecasting. "First, I think it is important to put in a process to determine the true excess," says Jaccard. A treasurer must know the right amount of cash to keep in a country in a normal business environment and, something which is of increasing relevance in the current climate, the right amount to keep in a stress environment. "There has been a lot of talk lately in the industry that cash flow forecasting is inadequate, which I think is a true assessment," he adds.

2. Look at the options for inter-company lending. Once the true excess has been determined, an investigation can begin into where that excess has come from. If there is a month-on-month accumulation because the company is unable to spend it locally, then inter-company lending might be considered, either through physical or notional pooling.

3. Use 'leading and lagging'. If an MNC has a distributor in China which is consistently long in cash, then the transfer pricing in accordance with country tax regulations could be adjusted so the value China buys at is more appropriate – a process referred to as 'leading'. 'Lagging' is the reverse. "A firm with a manufacturing entity that is chronically long could, instead of collecting payments immediately, give their group buyer longer payment terms so that, in effect, they use their excess to finance operations offshore," he says.

4. Work with your tax planner. If you've tried both cross-border inter-group lending, as well as leading and lagging, but you still have an excess of cash then you should begin looking at how you repatriate. "Once you get to this point, the problem is rarely an inability to do it – but rather the cost of doing it," he says. In the US, for example, repatriation payments are subject to a tax rate of 35%. But this can be made more cost efficient by careful planning. One example would be to pool the equity investments of subsidiaries into a location where the profit and loss positions net each other off, thereby delivering the company a lower effective rate of tax.

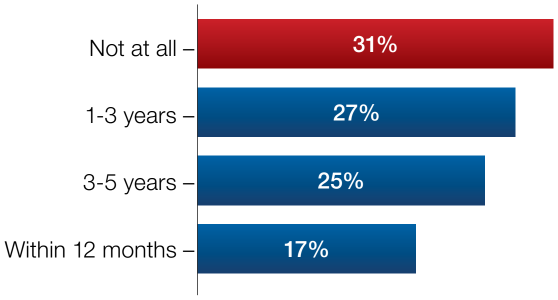
movements between the international header account and the domestic foreign currency account to the specified State Administration of Foreign Exchange (SAFE) or PBoC quotas.

A new dawn for Asia?

Despite the advent of limited cross-border lending in China, treasurers are not anticipating cash management within the region to be completely transformed overnight.

For example, in the 2012 Treasury Today Asia Pacific Corporate Treasury Benchmarking Study, almost a third of respondents stated that they do not see CNH/CNY actively being used for inter-company and third-party trade settlements. It will be interesting to see how much this changes in this year's survey.

Chart 1: Do you see CNH/CNY actively being used for inter-company and third-party trade settlements?



Source: Treasury Today Asia Pacific Corporate Treasury Benchmarking Study 2012

The 'nirvana' from a treasury perspective is to be able to pool cash in the same way as one can in Europe. "But that is almost impossible at the moment in Asia," says Greenwich Associates' Markus Ohlig. Although no one outside of the PBoC is entirely sure as to the exact timetable for the full internationalisation of the RMB, "the overall direction is now becoming clear. And looking back over the past year, the regulators have moved much quicker than a lot of people initially expected."

Ong thinks that the pace of reform in China over the past year has been encouraging. "What was impossible just a few months ago is now a reality for some companies," he says. Recent moves in Asia's largest and most important economy might also signal the beginning of a wider shift towards currency liberalisation within the region.

The cross-border lending schemes that have been introduced by SAFE and the PBoC over the past year was an important step and one which Ohlig thinks will be followed by similar initiatives in the regions other emerging markets. "Over the past decade there has been a steady blurring of the boundaries between highly and lightly regulated markets. Although the changes in China in recent months have been more dramatic than those in other countries in Asia Pacific, they only serve to highlight the direction regulation is taking in the region."

Good management of trapped cash requires effort

The experts all agree that companies should also focus on what can be done with the cash if it can be centralised and controlled more effectively. With relatively low interest rates persisting globally, cash held can be a drag on the overall return on capital. Therefore, getting hold of cash only resolves part of the problem.

Some companies are looking to invest longer term in an attempt to get yield, whereas others may accept more risk. Is there value in consolidating cash back home or in-region? Reducing or freeing up sovereign exposure may be a driver for others.

The shrewdest companies plan ahead and think about all these issues at the outset before expanding into a new jurisdiction. The way an investment is structured and funded can help lessen the amounts of cash that gets trapped. The objectives and capabilities of the company, as well as the involvement of local partners together with advice from your bankers and tax consultants, will all be needed to make prudent decisions – 20/20 hindsight is not enough. However, any structure will only be partly effective and you will need to be able to manage any amount of cash that is trapped.

Coping with nuanced regulatory regimes takes effort and may involve delving deep into a treasury's workflow. For example, in certain markets such as Indonesia and Thailand, the local currency is not transferrable on a cross-border basis. Thus if a company wants to lend on a cross-border basis, they need to convert the currency, usually into US dollars.

Due to foreign exchange (FX) cost considerations, companies will accumulate a 'normal amount' of at least $1m or more that is truly excess cash before making the conversion, in order to receive more favourable pricing. However, to do this efficiently, a company needs to establish the accuracy of its cash flow forecast in order to truly understand what cash is surplus.

Looking to the future

Most observers agree there is a continuing trend to liberalisation. Countries are trying to protect but not inhibit growth and progress. Some bankers see the introduction of Basel III as providing an opportunity to harmonise approaches – Malaysia, for example, is one of the first adopters. Others are less certain and point out that investor flows out of the region are slowing government and central banks' desire to continue along the path of deregulation.

Given the market stress recently affecting some Asian currencies – the Indian rupee in particular – might there not now be some hesitancy about following China's path? "China has become a role model for other nations in the region. I think others will follow its lead, but each country has its own considerations and therefore its own agenda and schedule," says ANZ's Jaccard.

Companies are well advised to keep watching new developments closely, concentrate on their biggest amounts of surplus cash and stay abreast of what can be done now and in the future. ■

Coping with low rates and changes in the money markets

The low yield environment in recent years has presented many challenges for corporate treasurers – and unfortunately this situation looks likely to continue. Jonathan Curry, Global Chief Investment Officer – Liquidity, and Nick Jones, Head of Sales, Liquidity, EMEA at HSBC, explore changes in the money markets and how new regulation is impacting corporate treasury.

There are a number of major changes taking place in the money markets that have been a consequence of the financial crisis in 2008. These changes are impacting all the major participants in the money markets from corporate treasurers and banks to money market funds (MMFs) and many others as well.

Ultra low interest rates

Ultra low interest rates have been a theme in the developed world money markets for a number of years now. This has had a consequence for investors who are earning a significantly lower return on their cash. "We have noticed a trend amongst investors to perform a major strategic review of their cash holdings and their investment strategy for this cash," says Jonathan Curry, HSBC's Global Chief Investment Officer – Liquidity.

The review has led corporates with surplus cash to consider strategic options such as increasing dividends, paying down debt, injecting cash into underfunded pension schemes. Many of those that have decided to invest their surplus cash have changed their investment procedures. Strategies used include increasing risk to earn a higher return, or investing in different asset types such as 'repo', segregated accounts and more.

These investors have decided to reallocate a proportion of their cash. They have adapted their investment strategy to take on more risk and investment in new asset classes. "However, we are not seeing a high degree of take-up in alternative products mainly because the majority of clients remain focused on security and liquidity as the key objectives of their investment policies," explains Curry. "At the moment, the risk/return trade-off has not made sense, so they have stayed with MMFs and other lower risk investment options."

With the market not expecting the European Central Bank (ECB) nor the Bank of England (BoE) to make any changes in short-term interest rates for the remainder of this year and well into next year, Curry expects "investors to continue strategically to look at options for their cash pools".

What investment options are available to corporate treasurers in this low yield environment?

There are a number of different investment options available all of which have trade offs relative to each other.

Investment option	Liquidity risk	Credit risk	Interest rate risk	Return	Watch out for!
Money market funds (MMFs)	Lower	Lower	Lower	Lower	Funds masquerading as MMFs.
Enhanced cash funds	Medium	Higher	Medium	Higher	AAA rated funds. Same day liquidity.
Segregated accounts	Higher	Investor driven	Investor driven	Investor driven	
Repurchase agreements (sovereign)	Maturity dependent	Lower	Lower	Lower	Documentation. Collateral liquidity. Operational.
Structured deposits eg HSBCs 'ENA' product	Higher	Medium	Medium	Medium	Cost of early redemption.
Call accounts	Lower	Medium	Lower	Medium	Unrated subsidiary. Regulatory change.

Risk remains

As noted, a number of structural changes are occurring in the money markets that are impacting all investors, whether they invest directly in the market themselves, or via a MMF or a segregated account managed by an asset manager. As a result of these changes, the industry faces new challenges.

"For example, we see a supply and demand imbalance for money market assets with shorter maturities," says Curry. The supply of money markets assets is being reduced, primarily through changes in bank regulation that are negatively affecting banks' incentives to issue short-term funding. This is increasing liquidity risk. It is also increasing risk through a reduction in diversification, as it is harder for investors to diversify to the degree they would like to.

On the demand side, investors have reduced the number of approved issuers. This is based on their changing perceptions of credit quality, which effectively begins to concentrate demand on a smaller number of issuers. In addition, investors, such as MMFs, now need to carry higher levels of liquidity post-crisis, reducing their demand for longer dated money market assets.

The supply and demand imbalance is creating challenges for MMF managers, as well as direct investors. It takes longer to invest on a day-to-day basis and it is harder to diversify as much as investors would like. As a result, the industry as a whole is more resource and research intensive than previously.

"We are also seeing governments putting new regulation in place in the financial services sector. Firstly to reduce the probability of another financial crisis and secondly to reduce the impact on the taxpayer if another crisis were to occur. The trend here is that in future regulation will allow debt as well as equity investors to take the risk of a bank failure. This development, plus an increase in collateralised lending by investors, has meant that if a default in the banking sector were to occur in the future the risk of being an unsecured debt investor is rising," says Curry.

In addition, credit ratings agencies (CRAs) are regularly changing their ratings methodologies. This has led to the re-rating of banks and a significant portion of sovereign credit in developed markets over the past few years. This has effectively shrunk the universe of available credit for investors that use external ratings as part of their investment guidelines. Plus CRAs are now much more reactive to market developments, which adds risk to managing money market investments by increasing market volatility.

The increase in risk in the money markets emphasises the importance of credit analysis skills and access to credit resources beyond external CRAs. Analysis of equity valuations and credit default swap (CDS) levels are blunt tools, and without dedicated credit analysts there are not credible options available to investors. This is a difficult environment for resource-strapped investors, who may not have the credit expertise to reduce their dependency on CRAs without limiting the diversity of their portfolio. For example, investors in Europe or the UK – with insight into the credit risk profiles of domestic or regional banks – will concentrate their investments geographically if they don't have the credit expertise to make informed decisions in outlying jurisdictions.

"One of the advantages of using external providers is that most, but not all, can look at credit profiles across geographies within the parameters set by a specific credit process. This will help to mitigate the supply and demand imbalance that is building up in the market," argues Curry.

Changing supply and demand dynamics are impacting money market investors

The credit crisis has led to profound changes impacting supply to and demand from money market investors

SUPPLY FACTORS – a reduction in supply of assets to investors		
Reduced short dated issuance from banks	**Limited issuance from highly rated corporates**	**Reduction in eligible issuers**
New regulation requiring banks to extend duration of funding.	Corporates have increased strategic cash holdings to reassure investors and respond to reduction in credit from banks.	With continued rating downgrades below those typically required by money market investors, the pool of eligible issuers has fallen.
A shift away from wholesale funding.		
Longer-term financing available from ECB via three-year LTRO.		
Deleveraging by banks reducing their need for funding.		

DEMAND FACTORS – A change in demand from investors		
Money market investors restrict approved issuers	**Changes to MMF regulation and practices**	**Increase in collateralised lending by money market investors**
MMFs have reduced the number of approved issuers based on changing perceptions of credit quality concentrating demand on a smaller number of issuers.	MMFs now carry higher levels of liquidity post the credit crisis reducing their demand for longer dated money market assets.	Focus on government only collateral.

New regulations

Currently, regulators consider MMFs to be part of 'shadow banking' and are prone to runs. Therefore, MMFs require reform. The regulatory debate is intense in all jurisdictions – in the US, Europe and elsewhere. Despite extensive collaboration and lobbying, there appears to be a worrying lack of objectivity and understanding amongst regulators. However, the industry can take some solace in the knowledge that the new regulations will take some time to implement as the changes are likely to be material.

In Europe, for example, the European Commission (EC) released its MMF reform proposals on 4th September, which was postponed from an earlier target date of 26th July. The next step is for the EC proposals to be voted on by the European Parliament (EP) and the European Council, before being written into law (if they are approved). This will be followed by a transition period for providers, investors and others involved in the industry to make the necessary changes. Therefore, it will probably be mid-2015 or later before funds need to be compliant with the new regulation.

In the US, the Securities and Exchange Commission (SEC) has released a consultation document, requesting comments by 17th September, in order to incorporate these suggestions into its final proposals for reform. These proposals are likely to be released towards the end of 1H14, and implementation will then occur in 2016.

Obviously, all stakeholders in the industry will need to make a number of changes in order to become compliant. Today, there remains much uncertainty that needs to be resolved before investors and industry stakeholders have a clear picture as to the final reforms. We need to see collaboration continue between investors, regulators and politicians as we go through this process.

HSBC Global Asset Management has been focused on clarifying what reforms are needed to make MMFs even more resilient and which reforms will not deliver this objective. "We do believe that there are reforms that will benefit all stakeholders in the money fund industry," says Nick Jones, Head of Sales, Liquidity, EMEA at HSBC, who goes on to say " the stated aims of the regulators are to reduce systemic risk in the financial system by reducing the probability of runs occurring in MMFs. Anything that makes MMFs more resilient to risk, whilst remaining proportionate and allowing funds to continue to provide a valuable service to clients, are clearly an objective that HSBC Global Asset Management supports."

For example, HSBC Global Asset Management would support a European regulation that stipulates a minimum liquidity requirement that MMFs should hold to give funds greater ability to meet redemptions, such as 10% in overnight and 30% in one-week paper. HSBC already follows its own stricter, internal policies in terms of how much liquidity their funds need to hold, and believe that this would be a sensible reform and improve a fund's ability to provide same-day liquidity.

HSBC also supports the following reforms for MMFs:

- 'Know your client' and client concentration policies.
- Equality between shareholders should be strengthened by empowering MMFs to impose a liquidity fee on redeeming shareholders during periods of severe market stress.
- Fund sponsors should not be able to support MMFs.
- MMFs should not be rated.

However, other reform proposals that HSBC does not support include:

- Capital/net asset value (NAV) buffers, which are ineffective in reducing run risk and brings into question the economics of MMFs.
- Differentiation of risk between constant NAV (CNAV) and variable NAV (VNAV) funds, which is a 'red herring' not based on facts.
- 'Hold back' mechanisms, which are ineffective in reducing run risk and operationally impractical.
- Restrictions on the usage of amortised cost accounting.

Impact on corporate treasurers

It is clear that corporate treasurers are being adversely affected by reduced yields. In general, money market investors have focused on higher quality issuers as supply falls and demand increases. The new environment is a strain on already limited resources in the treasury department due to an increase in time required to perform the daily investment function, as building a diversified portfolio is more challenging and hence time-consuming. As explained previously, to maintain a diversified portfolio some investors may have to go beyond their current area of credit expertise.

"Corporate treasurers will also see an increase in risk in a number of ways: firstly, as banks borrow more through central banks and repo, unsecured lending becomes riskier because losses would be greater if a default were to occur; secondly, as a result of rating downgrades and increased volatility in the market," explains Jones.

In addition, corporates may suffer from the fall-out if these new regulations remove an outsourcing option – in a worst-case scenario MMFs could be regulated away – and it is therefore important that they make their views known. Finally, it increases the probability of extreme market events, such as negative yields in core Eurozone Treasury bill and repo (with government collateral) markets.

Conclusion

Time will tell as to exactly what lengths the proposed reforms will go. But based on the direction regulators are heading, it is clear that there will be an impact on the industry as a whole, including corporate investors.

HSBC Global Asset Management will be assisting its clients in understanding the changes and their impact. "We also think it is very important that the voice of the investor is heard, particularly as we enter the political part of the process when the European politicians vote on the reform proposals. They need to understand the impact on corporates and what the reforms mean for the real economy," says Jones.

Therefore, HSBC Global Asset Management has been actively encouraging corporate investors to get involved in the debate, either directly representing their own organisation or through a relevant industry association. It is important that their voice is heard to make sure that it is factored into any decisions that are ultimately made. "Without this input, it would be difficult to make a fully considered decision on what is appropriate for the industry as a whole," says Jones.

In addition, understanding the consequences of reform is best practice on the part of the regulatory community and the politicians, to ensure that any reform is in the interest of investors in MMFs, who clearly value them as a cash management tool. But that tool needs to be available to them in a form that works for them.

Short-term investing – a checklist for corporate treasurers

Regularly review investment objectives and investment policies, for example:

- Liquidity requirements – the cost of liquidity has increased.
- Risk tolerance – risk levels in money market investing have been redefined by the credit crisis and Eurozone sovereign crisis.
- Have a position on strategic questions such as whether risk free assets still exist, or whether a bank is indeed 'too big to fail'.

Keep abreast of regulation (bank, MMF, etc) – it will continue to impact you:

- Regulation is changing how money markets operate and it is necessary to respond.

Resource level required to meet the riskier, more resource-intensive world:

- Review internal resource levels.
- Review outsourcing options, if resources are constrained.

Ensure a dialogue with your asset manager:

- How are they adapting their investment policies and processes to the changing markets?
- What is the breadth and depth of their credit resources? How is this changing?
- What are their views on regulatory change and the impacts on money market investors?

Make your views known:

- If you have strong views on investment issues that will impact you, make them known directly or through your industry associations.

Jonathan Curry – Global Chief Investment Officer – Liquidity

Jonathan Curry is Global Chief Investment Officer (CIO) for the Liquidity Business and has been working in the industry since 1989. Prior to joining HSBC in 2010, Curry worked as Head of European Cash Management at Barclays Global Investors (BGI). He is Chairman of the Institutional Money Market Fund Association (IMMFA), the industry association for AAA rated MMFs, and has been a Board member since 2006. Curry is also a member of the Bank of England's (BoE) Money Market Liaison Group and a member of the European Banking Federation's (EBF) STEP Committee.

Nick Jones, Head of Sales, Liquidity, EMEA

Nick Jones is Head of Sales for the HSBC Liquidity Business across EMEA and has been working in the treasury and banking industry since 1987. Prior to joining HSBC in 2004, he held treasury and cash management related sales positions at Bank of America and the former FleetBoston. Jones holds treasury and banking related qualifications with the Association of Corporate Treasurers (ACT), Associate of the Chartered Institute of Bankers (ACIB) and an honours degree in Economics. He is also a member of the Promotion and Investment Education Committee of the Institutional Money Market Fund Association (IMMFA).

HSBC Global Asset Management is a leading asset management firm with assets totalling $428 billion*. Liquidity asset management is a core competency of HSBC Global Asset Management with over 20 years of experience advising, executing and managing liquidity strategies. This is evidenced by the fact we have $63 billion of liquidity asset under management, representing 15% of our total assets under management (AUM)*. We employ dedicated liquidity portfolio management investment professionals who focus on active risk management, utilising the extensive credit research expertise of more than 30 analysts who are responsible for covering both liquidity and fixed income. With our extensive global reach, HSBC Global Asset Management is able to offer liquidity products in a range of 11 currencies, applying our consistent investment process to emerging currencies where clients may not be familiar with the local marketplace.

*Data as at end of March 2013.

The only way is ethics

For a business, 'doing the right thing' is important for a number of reasons. But is there a difference between a truly ethical business and one that has merely subscribed to a corporate social responsibility (CSR) programme? In the final part of Treasury Today's 'Sustainability' series, we consider these differences and look at how perception can affect business.

As large corporations expand globally, their relationships with and sensitivities to the communities in which they operate may naturally deteriorate. Centralisation and outsourcing, for example, can distance the decision-makers from the operational activities of the company. Expansion does not excuse a business from its social responsibilities, but the drivers for discharging these responsibilities may not be as genuine as some companies would have you believe.

Genuine or not, the concept of ethical business practice is nothing new. In the UK, for example, the Quaker involvement in business in the 18th and 19th centuries is well known: the four main chocolate companies of Cadbury, Fry, Rowntree and Terry are fine exponents of genuine corporate care (albeit with an overtly religious agenda).

According to Sir Adrian Cadbury, descendant of the Cadbury family, Quaker businesses not only respected the value of every individual worker (and made sure they were well looked after), but also had a code that insisted they maintain strict integrity in business transactions and in relations with individuals and organisations. It required its employees to be personally scrupulous and responsible in the use of money entrusted to them, and never defrauded public revenue.

Roll forward to 1932 and A.A. Berle and G.C. Means had just published 'The Modern Corporation and Private Property', in which they observed that the corporations of the day had grown so large as to have become "a means of organising economic life". They argued that within such an expanse had formed "a corporate system – as there once was a feudal system – which has attracted to itself a combination of attributes and powers, and has attained a degree of prominence entitling it to be dealt with as a major social institution." The authors thus asserted that corporate management "have placed the community in a position to demand that the modern corporation serve not only the owners but all society."

What's right for you

Operating 'for the greater good' is often seen as laudable, but 'good' is notoriously difficult to define. But the often impenetrable semantic debates about what is 'good' or 'right' or 'just' can arguably be replaced (at least by tabloid newspapers) by the application of a common sense (if not intuitive) response to a given situation. But does 'ethical' really equate to 'common sense'?

According to the 'Miniature Guide to Critical Thinking Concepts and Tools' by Dr. Richard Paul and Dr. Linda Elder (of the Foundation for Critical Thinking), "most people confuse ethics with behaving in accordance with social conventions, religious beliefs and the law". Instead, they argue, ethics is a standalone concept which can be defined as "a set of concepts and principles that guide us in determining what behaviour helps or harms sentient creatures". This still leaves the definition of those principles and their application to tackle which takes us back to square one.

Perhaps a vague notion of 'doing right' is as good as it gets. In a commercial context, the rise of corporate social responsibility (CSR) programmes in the 1980s and 1990s looked like businesses had caught on that they were (and are) increasingly being judged not only on their ability to deliver goods and services but also the way in which they impact on society and the environment. CSR policies are not necessarily the same as engaging with ethical practices – the former can be an outcome of the latter, but not the other way round – but they have a role to play beyond mere PR trickery by at least opening the corporate mind to ethical practice.

CSR, as typically enshrined in company policy, expresses a desire to minimise destruction of the environment, maximise the preservation of resources for future generations (usually referred to as sustainability) and respect the well-being of staff, customers and other stakeholders and the communities in which they operate.

But balancing the aforementioned depersonalising effects of globalisation and the need to drive profitability – after all, there is no business, ethical or otherwise, without capital – against just criticism (and there are many who rail against all corporates) and a desire to do right is difficult. The pressure to come up with a solution is becoming increasingly urgent as a younger generation of professionals rises up through the ranks, ever-more aware, in a media-saturated world, of the errors of 'ethical' judgement made by some corporations.

Indeed, according to a survey carried out by PricewaterhouseCoopers (PwC) in September 2008 (just as Lehman's hit the wall), graduates place a high value on good corporate behaviour. The survey sought the views of new PwC graduate recruits around the world. The respondents cannot reliably be considered a proxy for all graduates but figures showed that 88% want an employer with social responsibility values that reflect their own and 86% said they would consider leaving an employer whose values no longer aligned.

The age of reason

There is an interesting generational divide in the perception of and response to workplace ethics. US-based non-profit organisation, Ethics Resource Centre's (ERC) 2013 study highlighted this gap, noting some of the difficulties corporates may face when trying to align organisational and personal values when the latter can be so much at variance. For the purposes of the exercise ERC divided age into the following segments: Traditionalists (64-84); Baby Boomers (45-63); Generation X (30-44); and Millennials or Generation Y (18-29).

On this basis, and through the lens of the current economic environment, it appears younger workers are more willing to close their eyes to corporate misconduct if they think it will help save jobs. There is a sliding scale inversely proportionate to age on this matter, with agreement from 35% of Millennials, 22% of Generation Xs, 17% of Baby Boomers and 12% of Traditionalists.

But the economic downturn will not last forever; companies for whom recruitment of the best young talent (graduate or otherwise) is a key facet of their strategic development would be well-advised to meet this group's perceived ethical needs now, not least because the age scale tips in the opposite direction when it comes to the perception of an ethical culture and the level of engagement. Indeed, when employees feel they are working in an organisation where ethical conduct matters, they are more likely to be engaged in their job. ERC shows that the level of engagement lessens with age, with a sliding scale ranging from a maximum of 77% for Millennials, 76% of Generation Xs, 72% of Baby Boomers, down to 68% of Traditionalists.

In building an ethical programme that reaches and influences each generation it is essential to pay attention to these differences. ERC's studies over the years reveal that the younger the worker, "the more social interaction with co-workers will influence their perception of ethical matters". Conversely, the older the employee, "the more hierarchy, structure and visible company commitment matter" as they get their ethical cues from stated company values and senior management messages.

The impact on profit

If upholding moral integrity is seen as a direct route to profit limitation, the UK-based non-profit organisation, Business in the Community (BITC), has demonstrated otherwise. It has shown that companies' actively managing and measuring CSR issues financially outperformed their peers by between 3.3% and 7.7% over a five-year period. The Economist Intelligence Unit (EIU) also looked into the commercial viability of CSR and found that 74% of respondents to a 2008 survey said corporate citizenship "can help increase profits at their company". When asked for their firm's primary motivation for corporate citizenship, the top three answers all relate to the bottom line: revenue growth (16%), increasing profit (16%) and cost savings (13%). This is not perhaps the most ethical of reasons but if the policies have a genuine positive effect then 'doing the right thing' is clearly not a cost centre.

The ethics of investing

Ethical investing has many devotees: in 2011, 12.2% of the $25.2 trillion in total assets under management tracked by Thomson Reuters were involved in what it described as 'socially responsible investing'. But ethical investing is subjective. It depends entirely on the investor's view of what is and is not ethical behaviour by a company. Typically, a positive stance is sought on areas such as energy, waste and pollution, natural resource conservation, the treatment of animals, workers' rights, human rights, supplier and community relations and government interactions. But for some, so-called 'sin stocks' (such as pornography, tobacco, alcohol, weapons and gambling) may also be off-limits. In many cases the direct activities of a company may be obvious but its indirect connections may be less so. And just because a company does not fall under an easy ethical heading (such as a green energy business) does not mean it is unethical.

The financial instruments available are much the same as those available to all investors but true ethical investment adds another layer of research (and thus time and effort). Subjectivity aside, investment is typically in companies that aim to create positive change in the world (or at least have a neutral impact). If a business wishes to stand by an ethical investment policy it means looking far beyond company publicity material. The complexity of some funds also means direct or indirect ownership is uncertain, as indeed the Church of England recently found out when it was very publicly pointed out that it was unwittingly investing in the pay-day loan company, Wonga, and thus contravening its own ethical investment policy.

A question of business

In terms of everyday policy, most internal businesses decisions do not require soul-searching but where there is contention, according to Florida-based independent leadership consultant, Dr. Cathy Bush (Ph.D. in industrial and organisational psychology), some decisions that have ethical implications may be difficult for managers to tackle simply because that individual may not have encountered the issue before. "This lack of experience may be characterised by a great deal of ambiguity in terms of what to do," Bush has noted in a blog. She offers a number of guiding questions that may be used to help resolve the issue (or at least define it as one of an ethical nature):

- How would you define the problem if you stood on the other side of the fence?
- What is your intention in making this decision?
- Who could your decision or action injure?
- Are you confident that your position will be as valid over a long period of time as it seems now?
- Could you disclose your decision or action to your boss, CEO, the board of directors, family, or society as a whole without qualm?

The annual ERC report has repeatedly shown that employees who work in organisations with active ethics programmes – and where values such as honesty, respect and trust are seen in action at work – "generally report more positive experiences regarding a range of ethics outcomes". It lists the following possible improvements:

- Less pressure on employees to compromise ethics standards.
- Less observed misconduct at work.
- Greater willingness to report misconduct.
- Greater satisfaction with their organisation's response to misconduct they report.
- Greater overall satisfaction with their organisations.
- Greater likelihood of feeling valued by their organisations.

According to the American Society of Association Executives (which represents over 10,000 trade associations and individuals around the world), there are a number of questions that anyone working for a business may ask about that company's policies and procedures as a way of testing its ethical stance. These include:

- Why might good people in this organisation do unethical things?
- What are our organisation's values?
- Have we adequately articulated these values internally and externally?
- Does our organisation have written ethics policies, procedures or structures?
- To whom is our organisation accountable?
- What do we mean by success?
- Does the leadership of our organisation support the idea of an ethical workplace?

Affecting change

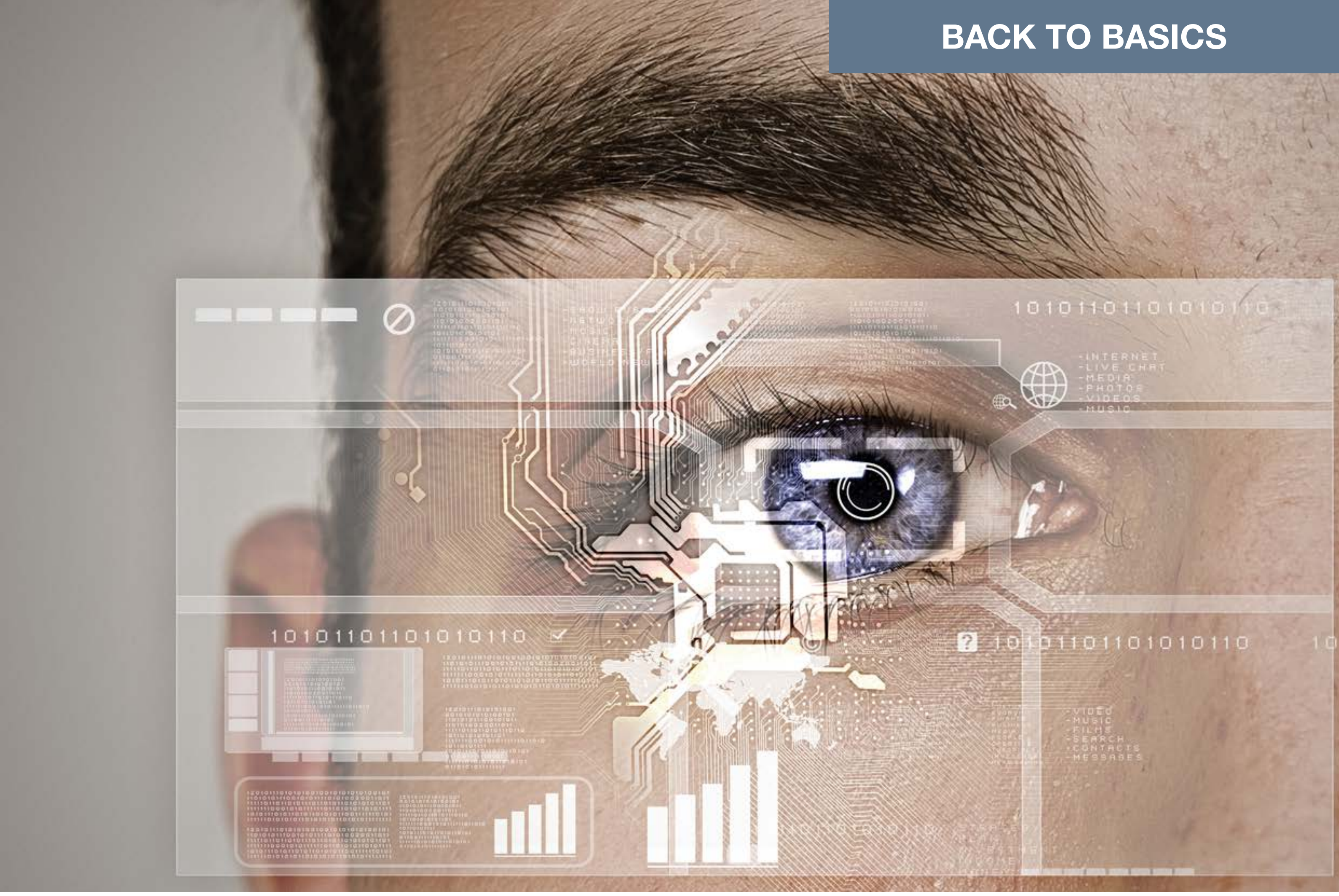
In assessing its most recent survey, ERC noted that "ethical conduct improves when the economy cools". Some 42% said their company had increased efforts to raise awareness about ethics. But ERC's historical data shows that as the economy improves, misconduct rises and reporting drops as employees feel more confident about their financial position.

The current improvements in perception of ethical behaviour shown by ERC's study may indicate a general swing towards a more considered approach but more likely, it says, it is a "snapshot of a workforce knocked off its historic trend lines" by a downturn that made people uneasy about job security. Now, as the economy slowly improves, behaviour is in the process of returning to the patterns seen in past studies.

Indeed, ERC reports "ominous warning signs of a potentially significant ethics decline ahead". It notes that retaliation against employee whistle-blowers "rose sharply", with 22% of those who reported misconduct claiming they experienced some form of retaliation in return in 2011. In 2007 the figure was 12% and in 2009 it was 15%. The number of employees who faced pressure to compromise standards in order to do their jobs rose from 8% in 2009 to 13% in 2011. Weak ethics cultures were perceived to be in 42% of businesses, up from 35% in 2009's survey.

Fluctuations in perceptions of ethical performance according to the prevailing economic environment suggest that whilst not mutually exclusive, business and ethics can make awkward bedfellows at times, even if it is difficult to state categorically what ethics actually means in practice. It is apparent too that pretending to be as pure as the driven snow is an act increasingly difficult to maintain. But the publicity generated by perceived ethical transgressions can damage corporate reputation irreparably, thus the pressure to perform should serve as a counterweight to any loss of 'ethical' focus. Whether the re-alignment of business stance to meet the views of stakeholders is driven by a genuine desire to 'do the right thing' or by the need to offset bad PR remains a matter of choice and conscience.

Either way, companies must be aware that there are many activists who will be only too happy to highlight acts of hypocrisy – any failure to respond positively to the just criticisms of an ever-watchful world is sheer folly. Ultimately, if the outcomes are the same, perhaps it does not really matter if a business is genuinely concerned about its impact on the world or is merely engaged in a PR stunt. After all, Adam Smith wrote in 'The Wealth of Nations' (1776) when discussing the impact of market competition on individual behaviour: "By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good. ■



IAS 39

When International Financial Reporting Standard 9 (IFRS 9) eventually becomes mandatory in 2015, treasurers will no longer have to apply International Accounting Standard 39 (IAS 39). But what was IAS 39 and why was it introduced in the first place? In this article, Treasury Today summarises one of the most complex accounting standards and explains why, following the recent financial crisis, calls mounted for a new standard to be introduced in its place.

Most companies use derivatives to mitigate or offset various financial risks such as interest, currency and commodity price risk. The objective of hedge accounting is to reflect the results of a company's hedging activities, particularly in instances where those hedges involve the use of derivatives. This allows companies to avoid the standard accounting treatment for derivatives, thereby escaping the temporary undesired volatility in profit and loss (P&L) caused by valuation and timing differences. However, at the present time, any corporate who wishes to apply hedge accounting treatment to its derivatives trades must meet the complex requirements set out in International Accounting Standard 39 (IAS 39). But what exactly does IAS 39 involve?

Setting standards

International standardisation of financial instrument reporting began in 1988, under the supervision of the International Accounting Standards Committee (IASC). During the 1990s, the committee attempted to devise a fundamentally new approach to developing a standard. But unable to secure a consensus on measurement issues, the initial standard released in 1995 was limited solely to aspects of presentation and disclosure. This problem persisted and in 1998, as the target date for IAS 39 was fast approaching and with next to nothing on the table, the Board decided to base the new standard almost entirely on US General Accepted Accounting Principle (GAAP). The committee only ever intended this to be an interim solution, however, and as a result IAS 39 went through a number of evolutionary adjustments over the subsequent decade as the International Accounting Standards Board (IASB), the IASC's successor, attempted to develop a workable and truly international standard.

The final standard

The final standard, adopted in January 2005, sets out the way in which financial instruments should be recognised and measured on a company's balance sheet. Below is a brief summary of the main principles embedded in the standard.

Under IAS 39, financial instruments are defined as "any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity".

One significant change was the introduction of embedded derivatives. Some contracts that do not appear to be financial instruments may have derivatives embedded in them – for example, leases which include an option to buy and debt instruments that give the option to prepay). The IAS 39 standard stipulates that any embedded derivative should be separated from its host contracts and accounted for as a distinct instrument. This treatment is the case when the economic risk and characteristics of the embedded derivative are not closely related to those of the host contract.

The IAS 39 standard covered three main areas:

1. **Recognition and derecognition.** The standard stipulates that all financial assets and financial liabilities, derivatives included, must be recognised on the balance sheet. Only when an entity is released from its primary obligation relating to that liability can it remove, or 'derecognise', the assets from its balance sheet.
2. **Measurement.** There are categories into which financial assets must be classified: fair value through profit or loss; held to maturity; loans and receivables; and available for sale. Financial liabilities, meanwhile, can be categorised as either fair value through profit or loss, or amortised cost.
3. **Derivatives and hedge accounting.** Under IAS 39, fair value must be used for the measurement of all derivatives, with gains and losses in the income statement. Derivatives, however, are often used to hedge recognised assets or liabilities. These may be recorded at amortised cost or at fair value with gains and losses recognised in equity or forecast transactions, causing a mismatch in the timing of income statement recognition. By changing the timing recognition in the income statement, hedge accounting corrects this mismatch.

The standard allowed for companies to adopt hedge accounting as long as the hedge is formally designated and documented and meets hedge effectiveness tests both prospectively and retrospectively.

The three types of hedge accounting permitted under IAS 39 were:

1. **Fair value hedge.** This is designed to manage the risk that there is a change in the value of an item (whether an asset or a liability) that is measured to a fair value and will have an effect on the income statement.
2. **Cash flow hedge.** This is designed to manage the risk that there will be volatility in the value of future cash flows that will have an effect on the income statement.
3. **Hedge of a net investment in a foreign operation as defined in IAS 21.**

Under the latest revision to IAS 39, fair value hedge accounting can also be used for a portfolio hedge of interest rate risk. This is often known as macro hedging.

Finally, IAS 39 determines the circumstances in which hedge accounting must be discontinued. These include when a hedge ceases to be effective, the hedged instrument expires or is sold or exercised, and if the company stops designating the relationship as a hedge.

Impact upon corporates

International accounting standards, such as IAS 39, were initially developed with the objective of creating greater transparency and consistency in the way in which companies report financial instruments by unifying the various rules relating to this process.

But in retrospect IAS 39 clearly had the opposite effect. The standard was extremely complex and, in some places, contradictory – particularly the section which related to hedge accounting. As a consequence, many companies struggled to apply the standard correctly when reporting their derivatives trades.

One of these companies was Volkswagen International Finance (VWIF) who, like many others, had struggled to implement the standard in time for the January 2005 adoption deadline, which the International Financial Reporting Standard (IFRS) board had suddenly announced less than a year before.

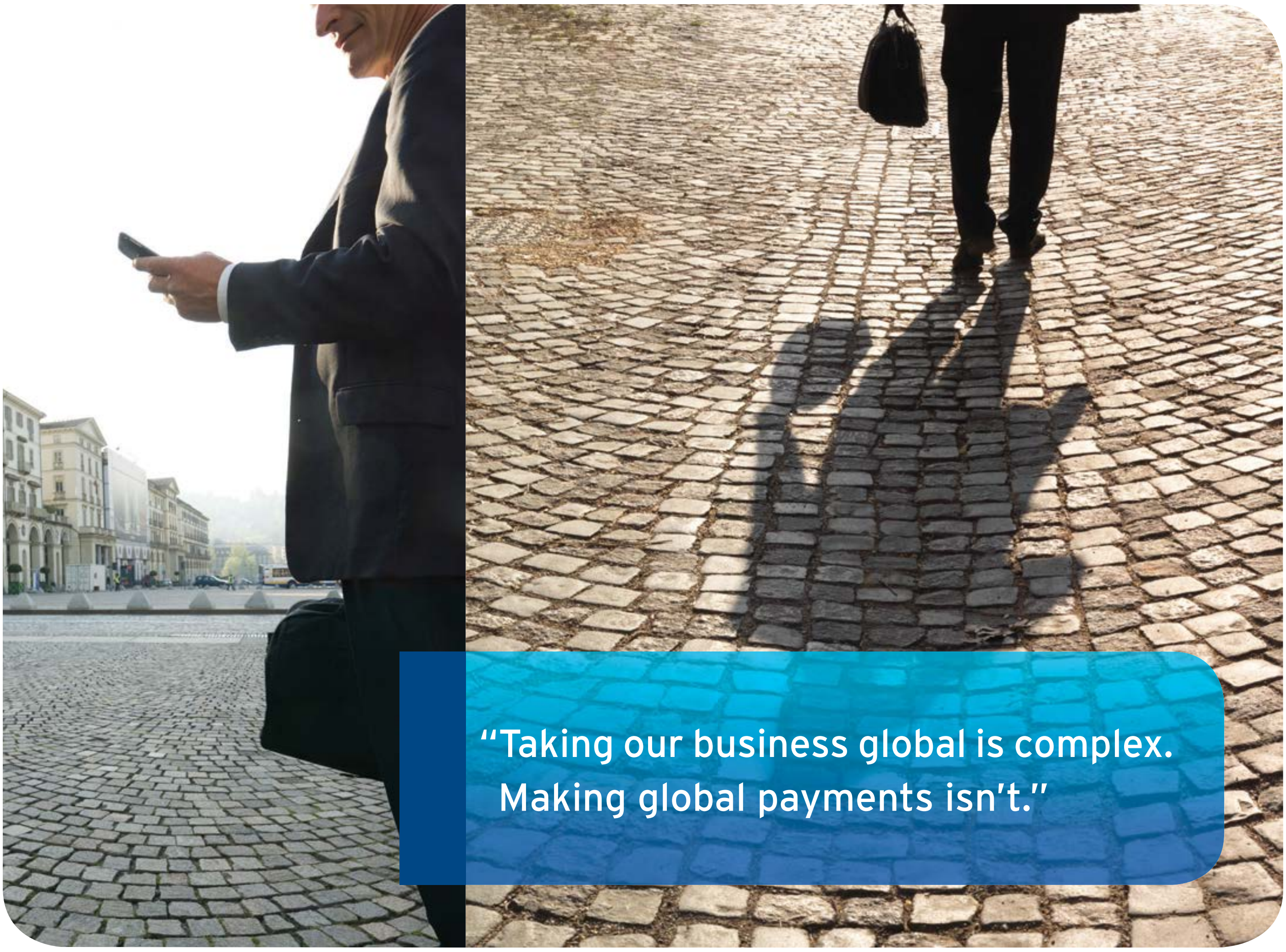
In an article in Treasury Today back in 2008, Volkswagen explained that the challenge was complicated further when the company consulted the accounting profession for guidance and discovered that what the audit firms classified as "compliant hedge accounting solutions" varied considerably. In the end the company decided to work with its treasury management system (TMS) provider, IT2 (now part of Wall Street Systems) to develop a tailored solution, which entailed sending the exposures to VWIF from the central SAP system. The company's TMS solution then derived the results and reported on hedge effectiveness both retrospectively and prospectively as stipulated in the standard. The solution went live the first week of December 2005 and 14 VW companies decided to use the hedge accounting reporting service.

IFRS 9: a fresh start?

Following the 2008 financial crisis, IAS 39 came under heavy scrutiny. Experts claimed that IAS 39's strict rules on fair value had contributed to the proliferation of toxic derivatives assets that nearly caused the collapse of the global financial system. In 2009, leaders of the G20 group of nations declared that financial reporting needed to improve and called upon the standard setters to reduce the complexity of the hedge accounting standard and make it less open to interpretation.

In response, the IASB announced that the introduction of a new set of accounting standards, IFRS 9, would be fast-tracked. A draft of requirements for hedge accounting, the third step in a tripartite group of proposals, were finally published in September 2012. Corporates wishing to use hedge accounting will have until 1st January 2015 to comply with new requirements.

Although IFRS 9 might prove to be less problematic than its predecessor, don't think there won't be more rules and room for further interpretations. ■



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