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Faster payments push ahead

Using the UK's Faster Payments Service as a template, various initiatives are under way across the globe to improve payments infrastructures and enable real-time transactions. But are these schemes likely to receive sufficient investment to realise their full potential?

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Bert Heirbaut
Treasury Manager
InterContinental Hotels Group plc

Women in Treasury
Annemarie Moore
Group Treasurer
Plan International

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Contrasting risk methodologies

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The rise of receivables finance

Regulation
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Country Focus
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Website Assistant
Joanna Smith-Burchnell

Business Proposition Manager
Colin Jones

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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Unplug and play

Without doubt, technology has revolutionised the way we work. But it has also altered the way we live. Mobile technology and remote access solutions allow us to work on the go, or work from home, yet in doing so, they have blurred the lines between our personal and professional lives.

For some employers, the ability to have their workers on tap 24/7 is highly desirable. In fact, many corporate cultures operate 'unwritten rules' expecting employees to respond to emails after hours, or continue to work on projects at weekends. Of course, there are always exceptional circumstances that demand an extra push, but when the working day is only broken up by eating and sleeping, the risk of burnout is high. And exhausted employees increased risk of error, absenteeism, stress and low morale, all of which will ultimately impact the bottom line.

In the corporate treasury function, where human resources tend to be stretched and accuracy is imperative, it is vital to have a team that is functioning at its best. This means recognising the difference between full capacity and full productivity – a trend which is gradually taking hold among key European multinationals, and even governments.

Volkswagen was one of the first movers here, announcing in 2011 that certain employees' work emails would be 'turned off' 30 minutes after the end of their shift, and only switched on again half an hour before the beginning of their next working day. BMW and Puma have introduced similar initiatives, and the German employment ministry announced in August 2013 that its managers were banned from calling or emailing staff out of hours, except in emergencies.

Similarly, trade unions for the technical and digital sectors in France have recently struck a – legally binding – deal with employers stating that they can no longer pester staff with out-of-hours emails. In fact, employees in those sectors are being ordered to switch off professional mobile devices to sever any communication links in time designated for 'rest'.

While banning out-of-hours email may be an extreme measure, not to mention totally impractical for treasurers working across time zones, these radical moves are designed to make a point. Namely that working longer doesn't necessarily mean working harder.

As one of Treasury Today's favourite forward-thinkers, Adam Smith, wrote in the Wealth of Nations, "The man who works so moderately as to be able to work constantly, not only preserves his health the longest, but in the course of the year, executes the greatest quantity of works."

In short, it pays to let your employees unplug and play.

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Bert Heirbaut
Treasury Manager

Bert Heirbaut, Treasury Manager at the InterContinental Hotels Group, has a head for numbers, which is an important quality in the person charged with managing the treasury function of the world's largest hotel group. With 687,000 rooms in 4,700 hotels in more than 100 countries, Heirbaut and his team play a vital role in maintaining the group's financial momentum.

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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

Heartbleed – what the treasurer needs to know

Cyber security risk continues to be a threat to companies and their data. The latest cyber menace to be discovered is Heartbleed, a major security flaw that affects over two-thirds of internet servers and can expose sensitive information such as passwords and bank details. Here is what every treasurer needs to know.

A critical defect has recently been discovered in the software which is used by an estimated two-thirds of internet servers to protect users' private information such as passwords and banking details. The defect, dubbed 'Heartbleed', was discovered by Google and Finnish software security firm Codenomicon earlier this month, and has since received a torrent of (often confusing) media coverage.

What is Heartbleed?

Heartbleed is a bug which is found in some versions of OpenSSL, a piece of open-source software which encrypts a user's communications with web servers all around the world. The software – often represented by the URL beginning with HTTPS:// and a padlock symbol in a web browser – is designed to secure the line of communication so the user can input sensitive information, confidentially.

The bug creates a vulnerability gap in this encryption which can be exploited by hackers to allow them to read the memory of the server and see the information which has been passed through it. This includes, but is not limited to: user names, passwords, bank account details and internal and external emails. The vulnerability ultimately allows hackers to steal data and impersonate services and users.

Steps to mitigate the risk of Heartbleed:

1. Although some major websites such as Google have indicated that users do not need to take any action, it may be a useful exercise to change passwords for any vital services, including VPN. Cyber security experts advise that passwords be changed regularly anyway, so now is as good a time as any to begin.
2. Create a list of websites and services which the treasury uses and determine whether any of these have been affected. Mashable offers a list of the Heartbleed status of major websites including email services and banking websites. Password manager LastPass also offers a website vulnerability checker.
3. Be vigilant over all accounts – email, bank and so on – which the department has accessed online and monitor activity closely, as well as backing up data and securing offline.
4. Ensure that all android mobile devices used by the treasury team are running version 4.1.2 or higher.
5. Speak to the IT department and ensure that, if a server is vulnerable, they replace the SSL certificate. Also, enquire about security testing for treasury going forward.
6. Continue to employ the basic cyber security measures as normal, as these remain your key defence against cybercrime.

Adaptive behaviour: a treasurer for all sectors

Beyond their core skills and competencies, treasurers can also benefit from the more nebulous ability to adapt to their environment. After all, what works well in one industry may be wholly inappropriate in another. Take aviation, for example. In an industry with highly seasonal cash flows, volatile oil prices (which typically make up 30-40% of an airline's cost base), rising airport taxes, new aircraft that often cost upwards of $100m, and slim profit margins, it takes a certain nous – and a targeted skillset – to successfully manage the treasury function.

Or consider a regulated utility, where there can be price caps, quality of service controls and environmental and financial restrictions. Here again the treasurer must be aware of the pitfalls and idiosyncrasies of the industry. For Network Rail, the owner and operator of Britain's rail infrastructure – and essentially a regulated utility – instigating its £38-billion capital investment programme, which was unveiled last week, over five years requires a large amount of cash. This will be achieved by issuing £5-6m of debt a year.

"We are not like a MNC that's got lots of multinational cash flows. We don't generate net cash. We are a net consumer of cash, because we borrow to fund the large infrastructure investment programmes out on the UK's rail network, and that debt has a government guarantee," says Samantha Pitt, Group Treasurer at Network Rail. The group's debt (in March 2013 this amounted to £32.1 billion) is backed by an unconditional, irrevocable and unlimited guarantee from the UK government.

Embracing corporate culture

Aside from sectorial nuances, treasurers should also strive to embrace a company's corporate culture. The treasurer of a private equity-owned firm is likely to be expected to take more risks and reach decisions much more quickly than treasurers in traditional corporate environments, for example. Similarly, the treasurer of a retail bank must put the customer at the heart of their decisions: "My job as the treasurer of a bank is to transfer funding risk from our customers onto TSB's balance sheet," Ian Firth, Treasurer at British retail bank TSB tells Treasury Today. "I gather together risks from across the opposite sides of the balance sheet and aggregate and manage them, to keep TSB's net risk as small as possible. I'm really a wholesaler of risk," he says.

Job hunting

Despite the idiosyncrasies of certain sectors, treasurers should not be put off from a move outside of their comfort zone – or should at least take the time to undertake their own assessment of the highs and lows of any potential new position, since there are numerous misconceptions about treasury work in certain sectors. Charity treasuries, for example, are not as far removed from traditional corporates as many people think.

"In many ways we have the same challenges as any global profit making corporate, because of our size and geographic spread. Plan International Inc is actually an American corporate but happens to be registered as non-profit. However whilst the financial risks that we manage are similar to a corporate's we have the additional responsibility of safeguarding donors funds," says Annemarie Moore, Group Treasurer at international development charity Plan International.

Indeed, contrary to popular belief, it seems it is possible to acclimatise after taking the step from private sector to not-for-profit treasury. "I thought I would find it difficult to adapt, and that the treasury function here would not be as sophisticated as I had experienced before. Whilst that was the case, they were looking for somebody who could really bring about changes in the treasury department, as the organisation grew, consistent with best practice," says Moore.

Staying fresh

So how are treasurers to develop this adaptive faculty? One way is by speaking to their peers, both within their industry and beyond. "We talk to fellow treasurers, particularly those in other regulated utility sectors, on a regular basis," says Network Rail's Pitt. "It's good practice to compare notes, and to check that our treasury policies and procedures are in line with other major corporates." ■

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

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This much I know

Annemarie Moore

Group Treasurer, Plan International

Maintaining a balance between one's professional and personal life can be tricky – how important is it to have a supportive employer?

Like most organisations today, my current company offers dependency leave. Since I commute and the school which my youngest child attends is too far for me to leave and then come back, having an employer who is happy for me to work from home on occasion is a real benefit. That said, it can sometimes be difficult to apply flexible hours within the treasury profession, given the various time zones, dealing deadlines and payment cut-off times.

What is the biggest treasury challenge you are facing right now?

The raft of regulatory changes we've seen over the past five years – particularly for derivatives – is the most significant challenge I and other treasurers are facing at the moment. Under EMIR, for instance, corporates are liable as well as financial institutions, yet corporates don't necessarily have the infrastructure and the management information systems (MIS) that banks have to help them carry out the reporting. In addition, the quantity of obligations and uncertainty over implementation has been burdensome. At Plan we use financial instruments for managing currency exposure but have had to implement regulation without increasing our overheads. Being an NGO we are mindful of costs.

Having said that, Dodd Frank and EMIR are now very current, so the workload on implementation is generally behind us in the treasury sector. The remaining ongoing challenge is finding yield in a risk averse manner in the Basel III and low interest rate environment.

What can treasurers do to get their voices heard within an organisation?

There is a triangle of flow here, relationships, knowledge and communication. From relationships one can understand the issues and latest strategy, which is knowledge. The knowledge provides opportunity to add value, to change. And the communication piece is the proposal followed by marketing for which one can fall back on relationships.

For my part, I do quite a lot of internal and external presentations. When there has been external change such as the euro collapse a few years ago or the advent of Dodd Frank, I have written papers for circulation internally to relevant management and for the Board, with regular revisions. In addition, as and when there are appropriate opportunities, I draw attention to the department's challenges and achievements.

Who has been your greatest career inspiration?

I was greatly influenced by my mentor from many years ago when I was a junior dealer in a bank. My treasurer at the time was a gentleman who decided I was going places and he took me under his wing to make sure that I did, I guess. He provided the environment for me to learn and broaden my experiences and for me to move the dealing room into further attractive and profitable areas. His parting words to me when he handed the Treasurer reins to me were, "you don't need to know everything, just know who to go to."

"His parting words when he handed the Treasurer reins to me were, 'you don't need to know everything, just know who to go to'."

ON THE WEB

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

In the early years of her career, Annemarie Moore worked in the back office at several international banking institutions, but always aspired to be one of the dealers or front office team. Taking on her first role as a treasurer at a merchant bank in the mid-1980s, the working environment in which Annemarie began her career was very different compared with the financial world today. "I think that was quite a big accomplishment," she says. "Not only was I just one of only a handful of women globally in that role, I was also in my late 20s as well – so still relatively young."

Her experience in banking, and particularly the understanding it gave her of how the 'other side' operates, is something Annemarie still finds useful in her current role. "I can relate to what the bank dealers are experiencing and accommodate and appreciate their difficulties, maybe in pricing certain sizes for instance. This understanding of how the other side works and their constraints has enabled me to put in place realistic procedures and policy."

A step change

In December 2006, Annemarie joined Plan International, a global child rights organisation, heading up the group treasury function. At the time, the organisation was planning a restructuring of the function and looking for someone to drive that change. Of course, Annemarie did not hesitate when the opportunity to try something exciting and different presented itself. "I had wanted to work in a company in which there was an end product at the time. A physical end product, such as a can of baked beans, seemed to me a more tangible way of adding value to society. But what is more tangible than directly improving the lives of thousands of children?"

The work of a treasurer at a non-profit organisation is actually not at all dissimilar to the treasury in the corporate world, she explains. The risks to manage and methods are driven by company exposures, whether domestic or international, and size – regardless of whether the treasury is in a profit making or non-profit making organisation.

There is one small but notable difference, however, that appealed to her. "The breadth of currencies we manage here is huge," she says. "We do have the same risks to manage and the scope of those risks is often larger owing to the number of countries we operate in. We are also mindful of our quasi fiduciary responsibility as the funds being managed and exchanged are donations. Preservation of value is paramount."

She adds an example: "For instance, if installing a latrine under a sanitation programme costs about £10 and if we can achieve a saving of £3,000 by purchasing Tanzanian shilling from bank A versus bank B, then we in the treasury department think of it as 300 latrines and each cost saving being achieved improves lives for children."

Diversity and equality

When Annemarie first undertook a senior role in treasury, the lack of women in the field was noticeable. "An early conference that I went to abroad in the late 1980s with international dealers staged a dinner for delegates and an alternate venue for spouses one evening. My husband found himself at a fashion show. He told me there were a handful of men amongst 500 or so female spouses."

Whilst no longer that extreme, Annemarie still finds that women remain under-represented at conferences. "Maybe as I remarked earlier, the market deadlines and timezones do not lend themselves to flexible working and that discourages women."

In her experience, opportunities to travel to conferences are often limited for professional women with young children. Annemarie has been lucky enough to have a supportive family, however. "My ex-husband is working in Dubai so my backup currently is my partner who is stepdad to my daughters, and my ex-husband's wife, who works locally, also steps in when I need support. Having said that, my children are older now – with the eldest being an adult," she adds. ■

As Group Treasurer of Plan International, Annemarie has developed a central treasury function that services the NGOs 50 programme countries and a turnover of approximately €700m in multiple currencies. In her time at Plan she has devised and implemented appropriate currency management and rationalised banking across Africa and Asia for the organisation. At any one time Plan's treasury manages between €120m and €160 equivalent of multicurrencies. The Treasury function that she has implemented has been highlighted in reports by Stamp Out Poverty and Better FX as 'best practice' regarding foreign exchange. The rationalising of banking that Annemarie implemented was a case study in Treasury Today in November 2011. Annemarie is on the Overseas Special Interest Group steering committee and the Treasury Special Interest Group committee of the CFG (Charity Finance Group) plus a member a of the Association of Development Organisations Treasures in the US. She has most recently implemented a Treasury Management system in Plan which she describes as a 'labour of love in that what you put into it is what you get out and I really want to see great efficiencies by using the system.' Within Plan she is a member of the Senior Finance Leadership Team. Prior to joining Plan Annemarie worked in an arm of Lehman Bros in securitisation, was a Treasury consultant and also Treasurer of a merchant bank.

Corporate pensions

> *What are the main issues preventing companies from reducing their pension deficits? Also, what practical steps can corporates take to begin to tackle these deficits and what should treasurers be doing in this respect?*

Raj Mody, Head of Pensions, PwC:

Deficits remain stubbornly on companies' balance sheets. This is due to a combination of artificially low interest rates, scheme members living longer than anticipated and pension schemes de-risking – which means schemes have a lower proportion of assets in equities than ever before and so do not really benefit from equity market increases. All of this creates an impression of a hole so deep and dark that there is no escape. But there are actions that treasurers can take to help their employers survive and thrive, notwithstanding their defined benefit deficits:

1. **Use available flexibility.** The UK Pensions Regulator has a new statutory objective to take account of the financial well-being of the sponsoring employer when considering plans submitted to reduce the pension deficit. The regulator has said publicly that employers can use the full extent of that flexibility and in particular can take account of the need to retain cash in the business for investment or to protect corporate solvency. This means that treasurers should assess the annual amount that the company can afford to pay to the pension scheme without damaging future company prospects. This should then set an upper limit to any negotiations between the company and the pension trustees.
2. **Ensure input of relevant expertise**. Treasurers could also participate in discussions on the shape of any proposed deficit recovery plan. It may be that the recovery plan could be lengthened or rear-ended, so bringing down the cost in the early years – particularly appropriate if the company is embarking on a growth phase. There is also scope to check whether trustees' proposed actions around hedging risks and using financial instruments such as derivatives take advantage of the skillsets and market relationships which a treasury function can likely supply. Treasurers should be actively represented in any trustee discussions on these matters, and should not hesitate to appoint their own strategic advisers to challenge the perspectives of the trustees' statutory compliance advisers.
3. **Examine non-cash funding**. There may be assets that can be allocated to the pension scheme instead of paying cash either directly, via an intermediate special purpose vehicle, or to back a company guarantee. This is a trend that has grown in recent years. It requires the identification of suitable assets but can help to preserve cash in the company while simultaneously reducing the pension deficit.
4. **Look for market opportunities.** Insurers' appetite for taking on pension schemes' longevity risks varies – there are times when longevity can be insured at a lower cost than it appears in the liability values. These opportunities tend to be temporary and often fleeting, so it is necessary to actively monitor the market if you want to have the chance to spot them and to act in time. In practice this requires real-time analysis tools that can help you remain alive to when these opportunities appear. It is only in very recent times that such tools have begun to emerge and the leading example by far is Skyval. Using such a tool enables the treasurer to identify the key variables, see and stress-test cash flows, and plan and execute in good time.

Finally, it remains the objective of many companies that still have defined benefit liabilities to remove them entirely from the corporate balance sheet. In doing this, volatility can be the friend of the treasurer. Undoubtedly there will be short windows of time when opportunities arise and the difference between success and failure may well hinge on the ability to act quickly. Success will look like pension rights secured and protected externally. Failure will look like internal post mortems over why opportunities were not seized. Real-time analysis may make the difference.

Paul Lee, Head of Investment Affairs, National Association of Pension Funds (UK):

When looking at how to reduce their deficits, pension funds face two core challenges, both of which increase their liabilities. The first is a familiar problem – longevity continues to extend. The second is one that is relatively new – quantitative easing, or QE, which has created a bond market where yields are unnaturally low.

Increased longevity is good news for us all but does bring with it a number of issues, not least for pension scheme funding. And while QE makes debt financing relatively cheap, and so may bring positive benefits for treasurers in other aspects of their day job, the flip side of this is that liabilities look far more substantial when assessed on standard yields. There is, however, nothing that a company can do to alter either of these two challenges, so let us consider what other options are available to them.

When looking at how to reduce pension deficits, broadly speaking, there are four possible courses of action: consider the level of benefits; increase funding to the scheme; make an asset-backed contribution (ABC); and, develop a closer working relationship with the pension fund trustees.

Evaluating the level of benefits offered to scheme members is an important option. Some moderation of benefits can be done relatively easily and is often completed early in the course of reducing deficits. The remaining choices are more complicated and often involve difficult discussions with employee representatives. Perhaps the most obvious solution is to provide more funding to the scheme. While bolstering the asset position in response to the calculated liabilities is simple and straightforward it is unlikely to be a financially attractive solution.

ABCs effectively lock up a property, or other asset, often in a Scottish Limited Partnership, for the benefit of the pension scheme – giving the pension scheme greater security while reducing the size of the scheme's deficit. When structured correctly, they can be reversed should the unwinding of QE lead to bond yields rising and resulting in a fall in the liabilities of the pension scheme.

The statutory role of pension fund trustees is to act as an independent solely in the interest of their beneficiaries. That said, trustees will naturally want to ensure the sponsoring employer remains financially robust as this is clearly an essential element in securing a pension scheme's future. This sensibility may help trustees and sponsoring employers to develop a measured contributions schedule. In the UK, the Pensions Regulator (TPR) has a new objective to encourage it to be more understanding of sponsoring employees' needs which should support productive and practical working relationships between trustees and sponsors.

Each one of these may not present a solution in themselves, particularly where a deficit is large, but increasingly we see trustees and sponsors working together to use some, or all, of these options to provide secure long-term futures for their pension scheme beneficiaries.

Sean Gilfeather, Head of Corporate Pensions, Actuarial, Lorica Employee Benefits:

Apart from the usual headline reasons, such as lack of available cash flow, employer lethargy, opportunity cost and so forth, there are many fundamental underlying issues that mean employers are either frightened to tackle deficits or are ill-equipped to tackle them. These include:

- **Ineffective trustee boards**. Trustees are empowered to manage significant risks on behalf of the members, but if they get it wrong, the employer pays the price. Despite advances in recent years in the standard of trustee knowledge and understanding, we're still seeing trustee boards where the constituents lack the experience and skills to have the confidence to manage the underlying risks and deficits effectively.
- **The role of the Scheme Actuary**. Many trustees, and indeed employers, still rely too heavily on their Scheme Actuary to provide them with the help and advice they need to reduce deficits. The role of the Scheme Actuary is clearly defined in regulation and employers must realise that a Scheme Actuary's main driver on a day-to-day basis is compliance with a raft of regulations – it's not their day job to help the employer to reduce the deficit.
- **Ineffective advisers**. The way in which advice and management of risks is delivered on behalf of trustees and employers must change. Time and time again, we come across advisers that are ill-equipped to provide clients with the most effective and cost efficient advice available. Many advisers' primary concern is achieving their chargeable hours or new business targets, rather than providing clients with the right advice.

How to remedy these issues

Treasurers must have more visibility over how defined benefit schemes are managed by trustees, and this can be achieved by:

- Maintaining an open and transparent relationship with the trustees and their advisers – this can be facilitated by sharing objectives and agreeing a long-term business plan for the scheme.
- Ensuring that the treasurer takes their own independent actuarial advice. Even though this will come at an additional cost, it should reduce the overall costs of servicing the scheme and help to improve their overall understanding of the underlying risks.
- Appointing an independent trustee, perhaps on a sole basis, as this will dispense with the need for other trustees.
- Improving awareness of the powers available to you as the sponsoring employer.
- Ensuring that there is a robust and transparent operational and governance framework in place. ■

The next question:

"I've heard a lot about making sure treasury is a strategic partner to the business. Can you clarify what steps treasurers can take to achieve this and what the benefits of such an approach are?"

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

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US economy improving: but how much?

Most economists assume that US growth over the coming year will be close to 3%. However, this figure could in fact end up being much higher. And while the Fed believes inflation is not a threat, and that it has every reason to keep interest rates as low as possible to ensure maximum economic growth – we should expect more, not fewer, rate hikes in the future, says ECR Research.

In all likelihood, Q1 growth in the US has been below rather than above 1.5%. However, this weakness occurred in the months of January and February, precisely when there was a cold snap hindering economic activity. To some degree, destocking may also have played a part. The March US payroll report, however, was encouraging. Around 190,000 jobs were created while the number of working hours rose substantially. This amounts to approximately one million extra jobs. Of course, job creation had declined sharply in previous months but this development is evidence that the economy is resilient and shows growth accelerated markedly in March.

On top of this, several indicators point to significantly higher job creation in April than in March. We think this shows that little has changed, relative to the second half of last year. During that period, growth was slightly below 3.5%, notwithstanding the government shutdown and the bad weather in December (without these factors, it might have been higher than 4%). At the time, analysts took a sceptical view because incomes were not rising much and consumers were deleveraging.

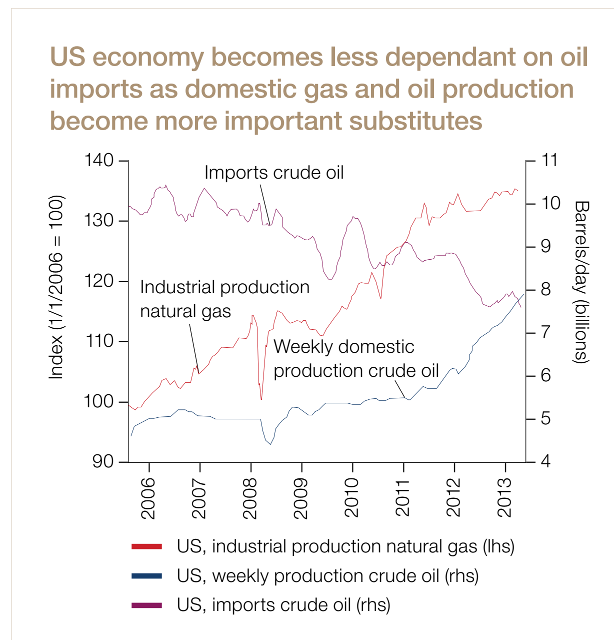
For the coming year, most economists assume that growth will be close to 3%. Conversely, we believe there is a fairly high chance it will be (substantially) higher, since:

- The easing off of fiscal drag will add around 1.5% to growth in the course of 2014.
- Monetary stimulus tends to have an effect on growth after an extensive delay. We think that will be the case this time too. After all, the process unfolds in different stages. Firstly, asset prices need to go up. Secondly, balance sheets need to improve until consumers and businesses feel sufficiently secure to borrow and spend more. Based on various confidence gauges, by now this has finally started to happen. Not to mention that many consumer balance sheets have strengthened so much that deleveraging may be coming to an end.
- Various signals point to rising wage increases. In combination with higher employment, this is boosting purchasing power.
- The expanding oil and gas exploitation is boosting US economic growth and US competitiveness has improved markedly.
- Surveys in the business sector indicate that many companies may be about to invest. In the recent past, businesses have often been hesitant, largely because of the turbulent political situation in the US and the uncertain economic prospects. In some ways, these factors have changed for the better.

Spotlight on policy

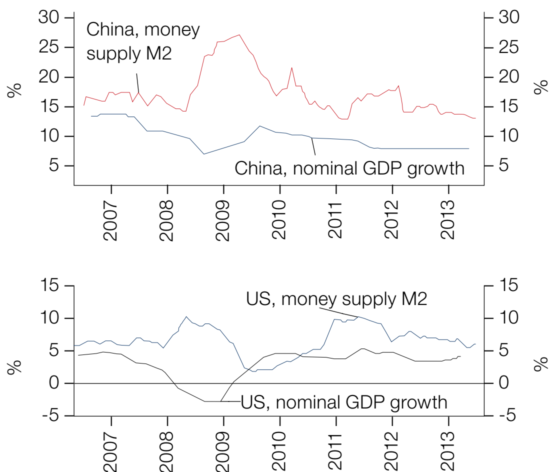
The next question is what does this mean for Fed policy? The central bank is not against higher growth as long as inflation risks are contained. If we consider the low rate of inflation of the past period, at first glance this threat seems minimal. Some Fed members are even worried about deflation. However, in our view, the risk of inflation should be taken more seriously.

In recent years, the Fed has created massive amounts of money. Normally, hyperinflation would have loomed a long time ago but not this time. The reason is that the money multiplier and money velocity were much lower because credit was tight, as result of the financial crisis. Presently (underlying) economic growth has exceeded 3% for a number of quarters whereas incomes are only increasing marginally. This has to mean that borrowing is picking up. In that case, the money multiplier and the rate of money circulation are on their way up.



Source: Thomson Reuters Datastream/ECR

Central banks worldwide created far more liquidity than the economy could absorb



Source: Thomson Reuters Datastream/ECR

Furthermore, US banks, businesses, and consumers have seen considerable improvements to their balance sheets. In addition, nominal economic growth is around 5% while the short-term interest rate is zero. The implication is that, for the moment, borrowing is attractive and very profitable indeed. All the more so as credit spreads are very narrow.

How quickly inflation will become a threat (as credit continues to ease) depends on the degree of spare capacity in the economy. As it increases, inflation risks ease. This reserve capacity is connected to the capacity utilisation in the business sector and the tightness of the labour market. If economic growth is just below 3% – and many economists are assuming this will be the case in the near future – capacity will remain underutilised. Especially as it is hoped that higher investment will increase productivity. On the other hand, the outlook will change dramatically if growth is well above 3%. Next, business capacity utilisation will rise rapidly as the labour market continues to tighten.

Rate expectations

With this in mind, the Fed's forecasts are fascinating (but let's not forget that the central bank's projections have often been off the mark). For 2014, the central bank anticipates growth of around 3% which is supposed to accelerate to 3.4% in 2015. On top of this, the Fed does not expect any labour market tightness for the foreseeable future and it maintains that the neutral interest rate is around 4%. (That is to say, a level where interest rates will neither boost nor hamper the economy). The Fed expects to implement a quarter-point rate hike every three months, starting from mid-2015. If so, its key interest rate will be neutral in 2019. Until then, the central bank thinks it can hold its benchmark rate at a level where it will continue to boost economic growth, albeit to a decreasing extent.

Naturally, the Fed has to contain interest rate expectations. As long as it thinks that inflation is not a threat, the central bank has every reason to keep interest rates as low as possible as this will ensure maximum economic growth. Everyone benefits if spare capacity disappears as soon as possible (first of all from the labour market).

Many economists think that inflation will be minimal for some time. As a result, analysts assume that bond yields will only rise by a few percentage points as economic growth picks up. If long-term interest rates rose by more, they would soon act as a drag on the economy. This is also reflected in the interest rate forecasts of the Fed and Bank of England members.

In some ways, this situation is reminiscent of the early 1980s. However, at that time, after decades of rising inflation, virtually no one believed the rate would drop sharply. It was considered a success if inflation did not rise further. In our view, the opposite applies now. We expect more, not fewer, rate hikes in the future. And not just because we believe growth will exceed 3%. In addition:

- The US job market appears to be fairly tight already. There is a substantial mismatch between the education and skills that businesses need and the actual competencies of many jobseekers. An ageing population aggravates this problem. Admittedly, so far wage increases do not point to a tightening job market as they are comparatively low. We expect major changes in the coming months, as it becomes clear that growth will be considerably higher than 3%. In the course of the year the labour market could tighten rapidly and wages will rise faster; especially for highly educated employees.

- As the nominal US growth rate is now rising to 5%, an unchanged Fed funds rate of near 0% will provide extra monetary stimulus for the economy in the year ahead.

- The Fed hopes that more investment will increase productivity. This would contain unit labour costs and thereby inflation. If experience is a guide, such developments cannot be predicted with any accuracy. The real outcome could be very different.

In our view, the yield on ten-year US Treasury Bonds could climb to 3.5%-4% by the end of the year as economic growth and inflation risks will rise more than most economists currently expect. In its wake, the yield on ten-year German government bonds may rise to 2%-2.25%. ■

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Faster payments: potential versus reality

With the UK having set the precedent, a number of initiatives are under way across the globe to implement faster, or immediate, payments systems. In this article we focus on developments in the Asia Pacific region and how these may influence faster payments in other geographies. We also question whether the true benefits of these schemes will ever be realised, given the limitations of local payments infrastructures.

Mobile and online technologies have made rapid progress in the past decade as smartphones have become ubiquitous and broadband communications have been rolled out across the world. Businesses and consumers have come to expect rapid access to information and want to conduct transactions in real, or near real time. These developments have not been matched, however, in the payments space. The majority of financial institutions are burdened with ageing core banking systems and myriad regulatory demands are monopolising resources that might otherwise be diverted to upgrade programmes. The relatively slow clearing cycles in the payments world are coming under scrutiny as consumers and businesses demand more agile systems.

Little surprise, then, that the UK's Faster Payment Service (FPS) which launched in May 2008 has been watched with international interest – certainly of late. Generally speaking, faster payment schemes enable customers to make electronic payments almost instantaneously, seven days a week, 24 hours a day. The payments are typically made via a phone or internet-enabled device and involve the transfer of money between accounts, to other people, to pay bills or to make regular standing order payments.

Although countries such as Nigeria and Poland also have real-time payments schemes in place already, one jurisdiction in particular is leading the way when it comes to faster

payments initiatives, namely Asia Pacific. Let's take a look at what is happening in the region.

Singapore

Singapore's Immediate Payments G3 scheme was launched in mid-March 2014 and supports credit transfers and direct debits. The scheme focuses on two principal areas: real-time payments (RTP, low-value real-time gross settlement) and bulk payments (automated clearing house). RTP features include payer-to-beneficiary payment completion within five minutes (up to a maximum of SGD 10,000) and payment completion within 15 seconds between participating banks, which are obliged to be able to receive and credit payments on a 24–hour-a-day, seven-day-a-week basis. The Singapore ACH for bulk payments has also been improved to provide support for additional details that will facilitate payment identification and invoice reconciliation.

G3 replaces Singapore's eGiro payment system that dates back to the 1980s. It will deliver real-time payment processing and automation of direct debit authorisations. The scheme will present operational and technical challenges for member banks, many of which are encumbered with ageing payment processing platforms and core systems. Moving from the eGiro system, member banks will have to update their payment systems to be compliant with ISO 20022 payment messages, real-time service levels, a 24/7 operating environment and provision for multiple clearing and settlement cycles.

The initial phase of the scheme – real-time payments – came into effect on 17th March this year. Phase two, which involves bulk payments (G3 Bulk), is due for launch in September or October. The final piece of the jigsaw, an electronic direct debit authorisation (EDDA) system is expected to be rolled out in late 2015.

The direct debit authorisations will be set up and exchanged electronically, leveraging the scheme infrastructure and capabilities to support the adoption of a bulk payment and will benefit real-time debit transactions. It will reduce the turnaround time required to set up an authorisation from the existing 12 to 15 working days to five working days or fewer, depending on the readiness of billing organisations' banks and the billing organisations themselves. Amendments and termination features will be included as part of the module.

VocaLink, which designed, built and runs the Faster Payments Service in the UK, has partnered with Singapore-based payments solution provider BCSIS, to deliver its Immediate Payments in Singapore as the real-time payments infrastructure for the G3 scheme. There are some differences between the Singapore scheme and that in the UK. Singapore is using the more modern ISO 20022 standard, whereas the UK scheme is based on the ISO 8583 messaging standard.

"A lot of work had to be done to upgrade the VocaLink system to operate on ISO 20022," says Stephen Peters, a Vice-President at Clear2Pay, which is also involved in the project. "Within G3 the banks participating will have to implement solutions that will interface to the central hub through secure, transparent networks. If they are processing real-time payments they will have to upgrade their core banking systems because many existing systems cannot deal with that flow of real-time payments; they are set up around batch or overnight processes." Several banks in Singapore are using Clear2Pay's Open Payments Framework as a module to run the G3 scheme.

India

India is also undergoing significant changes and improvements to its clearing infrastructure. One of the main developments is the Interbank Mobile Payment Service (IMPS, now called the Immediate Payment Service), which is live at nearly 60 banks. Introduced in November 2010 by the National Payments Corporation of India, the service is a mobile remittance solution. It offers an instant, 24/7 interbank electronic fund transfer service through mobile phones. Customers can use mobile handsets or tablets as a channel for accessing their bank accounts. Payments are transferred in a secure way and confirmation is immediately issued.

The IMPS platform processes person-to-person, person-to-account and person-to-merchant remittances. Transactions can be initiated from mobile phones, internet-enabled devices and from ATMs.

Applications of IMPS include the purchase of goods from stores via users' mobile devices and online purchases via internet-enabled devices. IMPS offers multiple modes of funds transfers for mobile purchases, including a mobile application, SMS and a national, unified unstructured supplementary services data platform. Funds can also be transferred over the internet via accounts registered to IMPS or other accounts, using the Indian Financial System Code. The ATM network is also hosting IMPS payments, enabling funds to be transferred.

A challenge for promoters of IMPS is the patchy nature of mobile coverage across India. The Indian mobile network is relatively slow and is also unreliable. At this stage, IMPS is dependent on a mobile device and on users having bank accounts. According to the Reserve Bank of India (RBI), as of December 2013 IMPS payments represented only about 1% of India's total payments volumes, with only 1.93 million payments made via the scheme in that month, compared with the more than 60 million payments cleared via the National Electronic Funds Transfer (NEFT).

The RBI says, however, that IMPS has improved the efficiency of mobile banking by enabling real-time transfer of funds between bank accounts and providing a centralised interbank settlement service for mobile banking transactions. The IMPS has also been enhanced to support merchant payments using mobile phones to promote a move towards a cashless society. An option is being considered for mobile merchant payments whereby merchants, on initiating the payment request, complete the transaction by accepting an OTP generated by customers on their mobile phones.

The IMPS initiative has been helped by the Reserve Bank of India's support and encouragement of electronic payments. The country's electronic payments systems are being upgraded and there has been significant growth in the use of the two electronic clearing systems, NEFT and RTGS.

Australia

While developments may have stalled in India, the idea of faster payments has gained more momentum in Australia. A project is underway to modernise the country's payments system, which to date has been based on bilateral clearing arrangements.

Faster payments will be ushered in on the back of the New Payments Platform (NPP), a new infrastructure for Australia's

low value payments. It will provide businesses and consumers with a fast, versatile, data-rich payments system for making their everyday payments. An industry steering committee is overseeing development of the NPP. Chaired by Paul Lahiff, the New Payments Platform Steering Committee comprises senior representatives from the Australian banking and mutual sector, an alternative payments provider and the Chief Executive of the Australian Payments Clearing Association, Chris Hamilton. The Steering Committee appointed KPMG as programme manager to the project.

The NPP will comprise a basic infrastructure, which all financial institutions, and through them businesses and consumers, connect to. This will enable payments to be made quickly between financial institutions and their customers' accounts. The system will enable funds to be accessible almost as soon as payment is received – even when the payer and payee have accounts at different financial institutions.

The idea of the NPP is to provide an infrastructure that will support value-added services developed by individual financial institutions. The multi-layered infrastructure has been designed to promote competition and drive innovation in payment services.

The NPP is being developed collaboratively by authorised deposit-taking institutions. A total of 17 institutions are taking part in the programme, including Australia's 'big four' banks: ANZ, Commonwealth Bank, National Australia Bank and Westpac. Foreign institutions such as Citi, Bank of America Merrill Lynch, ING and HSBC are also involved. The NPP is the Australian payment industry's response to the central bank Reserve Bank of Australia's strategic objectives on payments innovation.

Drivers and benefits

While the ability to meet the increasing demand of consumers and businesses for more rapid response times is one driver behind the implementation of faster payment schemes, there are other forces at work. Lahiff says many financial institutions have responded to the desire of consumers for faster or real-time payments, but to date only within their own institution. "The Australian payments market's move from a bilateral system to a multilateral approach will enable us to make faster payments between banks, rather than just within a financial institution," he says. A benefit for businesses, particularly small and medium enterprises, will be the ability to have more data accompanying payments.

In a review of innovation in the Australian payments system, published in 2012, the RBA found a demand among both consumers and businesses to make real-time payments. Rather than mandating a specific solution, the RBA has required the payments industry in Australia to meet this demand by the end of 2016.

"The RBA's view is that faster payments will be good for the Australian economy, because fast money is more efficient money. Consumers and businesses will have more choice to make payments safely," says Lahiff. "We are trying to provide a fast, versatile, data-rich payment system for making everyday payments."

Clear2Pay's Peters agrees with this assessment: "The driving idea behind faster payments initiatives is to increase the velocity of money moving through the economy by accelerating the clearing and settlement of payments. The hope is that once money is cleared by the system it will have a follow-on effect into the general commercial environment. If money is received instantly, goods can be shipped more quickly and the economy speeds up."

Peters is less sure about the impact faster payments will have on corporates, particularly large organisations. "The operations of large corporates are based on overnight settlement. It is difficult to see at this stage what the long-term effect of faster payments will be on these organisations. Possibly there will be an impact on corporate treasuries' operations and liquidity requirements. Faster payments may give a clearer, near real-time view of liquidity positions."

The ultimate success of faster payments schemes will possibly reside with financial institutions; as with the Australian scheme, it will be up to the banks and other organisations to develop new and innovative products and services to complement the faster payments. However, many banks are burdened with ageing core banking systems and upgrading these is costly.

The development of Faster Payments in the UK was a slow burn initially, with banks rolling out the scheme very slowly and to little fanfare. A similar scenario is playing out in Singapore, where the MAS has kept fairly quiet about the G3 project, wanting to ensure the platform is stable before promoting it widely. Many banks in Singapore are adopting a wait-and-see approach, enabling the trailblazers to test the market first.

It is possible that some banks may see more rapid payments as a differentiator for corporate banking services. By enabling Singapore banks and financial institutions to process low value payments in real time, innovative and commercially attractive banking products could be developed to counteract the threat of new market entrants, while minimising settlement risk and offering customers the surety and guarantees of a bank-based payment. By moving money at a higher velocity, the MAS hopes the economy and Singapore's business community will benefit and will keep Singapore at the forefront of regional payments and set the benchmark for innovation.

The future of faster payments

Despite the radical introduction of the FPS in the UK, it has taken around five years for the market to gain momentum and be widely recognised. However, proponents of faster payments say schemes can provide a platform for value-added services, improving the efficiency of payments systems and ultimately bringing down costs.

Building on the Faster Payments platform in the UK, Barclays for example, has developed Pingit for corporates, an extension of its retail instant payments solution. Corporates can integrate mobile payments into their multi-channel customer strategies. Barclays says this will enable corporates to improve their cashflow, increase their level of customer engagement and grow their businesses.

Many countries around the world, not just in Asia, are investigating instant payment schemes. The US Federal Reserve Board, for example, is encouraging US banks to introduce faster retail payments as part of a wider effort to modernise the country's payments infrastructure. As more and more countries look to upgrade their ageing payments infrastructures, faster payments will inevitably become ubiquitous – it just may take more time than proponents would wish. ■

Receivables: overhauling working capital management

With billions estimated to be tied up in excess working capital, optimising the flow of funds through the financial supply chain will surely continue to be a top priority for European companies in the years ahead. But how are transaction banks, technology solutions and treasury itself, changing in the quest for ever greater working capital efficiency?

Since the financial crisis, corporates have been labouring to rebuild balance sheets to ensure short-term obligations can be met in future stress scenarios. It is a goal which has led, among other things, to a renewed focus on working capital management with some companies pulling down old, localised structures and starting again from scratch.

In a panel discussion at the 2014 Receivables Finance International conference in Warsaw in April, representatives from both the corporate and banking world debated some of the changes seen in recent years. Treasurers, the panel unanimously agreed, are now taking much greater ownership of working capital performance at group level – a trend most visible in the recent post-SEPA vogue for payments and collections factories.

"We are seeing more and more corporates now giving their treasuries the mandate to fully manage and optimise their working capital from end-to-end," Eugenio Cavenaghi, Director of Trade and Working Capital at Barclays told delegates. In this new paradigm, treasury's mandate to find efficiencies across the procure-to-pay (P2P) cycle is becoming less tacit and more formalised, he adds. "Consciously they have taken ownership of working capital and, as a bank, our challenge is to present a set of solutions that helps them as owners of working capital to meet the challenges they face."

One of the ways banks are helping treasurers meet their working capital challenges is through the financing of receivables (see the fundamentals box at the end of this article for a reminder of common techniques). It is an activity which has seen spectacular growth in recent years. Since 2009, domestic invoice factoring across the globe has grown at a compound annual growth rate (CAGR) of 13.1%, while cross-border transactions have seen an even bigger upsurge, with a CAGR of 24.8%. Once considered as a last resort for companies that had become too risky for conventional loans, receivables financing is evidently much more mainstream now. Even large multinationals with investment-grade credit ratings are realising the benefits it can bring in terms of working capital optimisation (WCO).

Taking control

One company that epitomises this fresh approach to working capital optimisation is Siemens. Friedemann Kirchhof, Head of Supply Chain Finance at Siemens began by telling delegates the journey his company has taken since beginning to explore working capital improvements over a decade ago. The company, he explained, decided a more centralised methodology was required. A split approach was taken; one unit was assigned responsibility for the physical supply chain while another brought in expertise to bolster the financial supply chain – both forwards and backwards.

On the forward side, Kirchhof oversees the group's efforts to improve DPO through extension of SCF facilities to strategic suppliers. But the most novel aspect of the system, perhaps, relates to the receivables side and the establishment of a 'credit warehouse'. Siemens were dealing with large amounts of receivables data from its multiple business units and wanted to get a clearer picture of which companies posed extraordinarily high credit risk globally. The Siemens Credit Warehouse is an in-house unit that provides bank-like services to the company's entities. Its principle function is to purchase and bundle the short-term trade receivables from subsidiaries and manages the Group's credit risks by selling, securitising or hedging exposure to specific customers.

"For the moment, it is more of a risk management tool used to gain transparency on where our customers' risks are," said Kirchhof. "But there is the option on the receivables side, when it is needed, to turn them around very quickly into cash."

Tools for the job

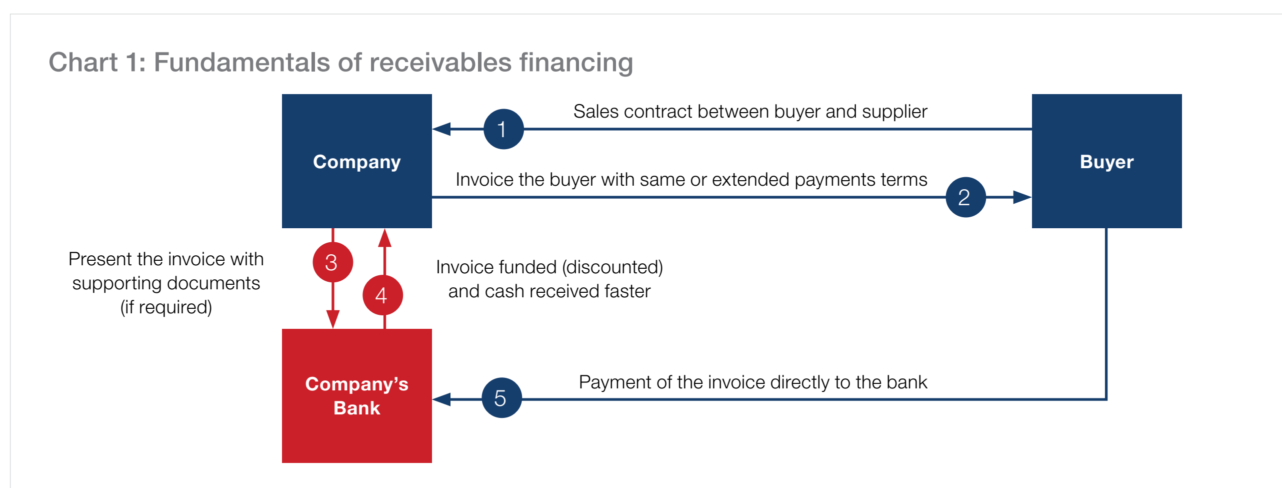
New concepts such as Siemens' Credit Warehouse have led banks and treasury technology specialists to develop up-to-date services and solutions to assist corporate treasurers with the evolving challenges they face. In fact, such has been the pace of technological advancement in treasury over the past few years there is an argument that solutions are now often leagues ahead of what processes can actually achieve, says Robert O'Donoghue, Managing Director and Global Head of Working Capital Management at ING.

O'Donoghue offers the example of a client that used SCF to extend payment terms only to see any benefits cancelled out by the time it took them to approve invoices. "Although I think it is clear that technology is an enabler," he explained, "if you've got a SCF programme that extends your terms to 60 days, but it is taking you 45 days to approve an invoice, then you have a problem."

Evidently, treasurers today need to focus on more than mere DPO improvements. Solutions that have the potential to speed up DSO, such as the Bank Payment Obligation (BPO), should, therefore see increasing acceptance in the coming years. That is provided bankers can overcome their initial hesitancy and begin building strong commercial propositions. Angela Koll, Product Manager International Business, Commerzbank believes that will be key to the success of the BPO, as it often is with treasury solutions. "We are trying to motivate everybody to look at this and encouraging banks to become more active in this space," she says. "If we don't, then there is a chance the instrument will fail to fully enter the market, and that would be a real pity."

Going mainstream

Given the evident success of the Credit Warehouse approach will others be following Siemens' lead with their own centralised solutions? In the long run, almost certainly, says Barclays Cavenaghi. "We do expect that once corporates have done their homework then concepts such as payments and collections factories, and what Siemens is doing right now with their Credit Warehouse, are going to become much more mainstream." SEPA, he adds, now makes all this easier to implement. "Once you have an overview of your receivables profiles across a number of countries those volumes will become much more visible and it will make more sense as a corporate to look at solutions that gets them off the books."



Source: PwC 2014

Receivables financing: the fundamentals

Factoring

In a factoring arrangement, finance is provided by a third party, the 'factor', who provides the supplier with a cash advance of (usually) up to 80% of the face value of the invoice. The factor then takes over the task of chasing in payment from the purchaser. Once payment has been received, the factor pays the supplier the remainder of the invoice value, minus a discount. Factoring may be done with or without recourse. Factors are frequently, but not always, bank-owned enterprises. Although traditional factoring only deals with the supplier side of financing, factors sometimes provide billing and collection services, so the buyer will be aware of the arrangements in place.

Invoice discounting

As in a factoring arrangement, payment is advanced to the supplier based on outstanding invoices. However, the invoices remain in the possession of the supplier, who is still responsible for collecting the outstanding payments. As such, the arrangement should not be visible to the buyer. Usually up to around 80-90% of the value of the invoice is advanced; however, some discounters will increase the advance against the security of assets including stock, machinery, land and buildings. Once these have been paid into a trust account, the discounter collects the payment and pays the supplier any outstanding funds minus the discounting fee. Invoice discounting can provide an effective method of improving or stabilising cash flow, though this may not be the most cost-effective financing solution for all firms.

Forfaiting

Developed in Switzerland in the 1950s, forfaiting is generally used to finance longer-term receivables and may be used by suppliers selling on extended credit terms of three to five years, although time horizons can vary from as little as six months to ten years. This flexible discounting technique can be particularly useful in turbulent times, as the uncertainties to contend with and consider when deciding whether or not to extend long-term credit now include heightened commercial and country risk.

Unlike a factoring or invoice discounting arrangement, which is based on the invoice itself, the forfaiter purchases drafts of letters of credit, accepted bills of exchange, promissory notes or other freely negotiable instruments on a non or without recourse basis, and for 100% of the value. The forfaiter then takes on the responsibility of chasing in the debt or alternatively sells the instruments to another investor. Finance can usually be arranged on either a fixed or floating rate basis. A guarantee or aval is usually required from the purchaser's bank in support of the supplier's obligation.

Receivables securitisation

For larger companies, more complex financing solutions might be employed. One such technique is receivables securitisation, which involves the sale of a portfolio of receivables without recourse to a special purpose financing vehicle. In practice, most companies use a revolving pool of receivables as these are generally short-lived. This means that once receivables are paid, they are replaced with new ones. Under normal market conditions, the special purpose vehicle issues securities to the capital markets based on these receivables. Meanwhile, the company's receivables are replaced with cash and are therefore not included on the balance sheet.

Unfortunately, the financial crisis meant that use of the structured finance market, and securitisation in particular, was reined in for a period of time. However, efforts have been made by governments worldwide, particularly in the US, to re-open the securitisation channels and market opinion agreeing the concepts behind it are fundamentally sound, the unfairly maligned practise appears to be in the early stages of a comeback. It is the way that securitisation is put into practice that needs to be addressed, and the return of securitisation is expected to bring less complex and less opaque structures to the market. Where available, receivables securitisation can be a good source of alternative funding for those companies that have been subject to credit rating downgrades.

Not every corporate has the resources to set-up its own in-house unit to sell-on receivables though. What steps can smaller, less technologically sophisticated corporates do to unlock greater efficiency within their supply chains? "For other companies, who lack the benefit of a "credit warehouse" like Siemens have, the important thing is to discuss the strategy on payables and receivables with the areas of the company that are buying and selling," Anil Walia, Head of Supply Chain Financing at RBS told Treasury Today in a later interview.

Breaking down silos in the buying, selling and finance functions remains the biggest working capital challenge for many companies. Walia believes a large part of the problem is that the departments speak different 'languages'; if procurement, sales teams and finance all understood each other's objectives better greater efficiencies could be realised across the business. "The key performance indicators (KPIs) of the various business divisions are sometimes contradictory. If KPIs of the buying, selling and finance functions could be harmonised to a greater extent, that would be the first step in breaking down the silos," says Walia. At Siemens, KPIs are already improving as a result of their centralisation efforts. However, Kirchhof cautions that treasurers should not expect miracles overnight. Making such changes naturally entails a lot of hard work and sometimes, he adds, it can take a while before the impact is seen. "It takes a lot of discussions, presentations, internal and external arguments to get there. But in the end you see more than a working capital benefit – you are bringing stability and structure into your supply chain."

Maybe the benefits won't be visible immediately. But that should not deter any treasurer from looking to garner longer-term working capital improvements. ■

Money market funds: making more of a changing world

In a constantly changing short-term investment environment we examine how money market funds can provide treasurers with a valuable source of independent credit analysis, portfolio diversification and liquidity.

Investors in the short-term money markets, already coping with the continued low-rate environment, have also been subjected to reduced money market issuance over the last few years, depleting the pool of suitable assets to invest in. Whilst life is slowly coming back to the sector as economies begin to emerge from the gloom – and measures taken by certain authorities to provide relief start to take effect – the fact remains that the short-term money markets continue to feel unsettled.

Money market funds can help treasurers deal with the changing nature of the short-term money markets and professional fund managers can provide the essential understanding and analysis investors require to steer their way through the uncertainty, particularly if policy dictates that they no longer have access to some of the issuers they previously felt most comfortable with.

Supply uncertainty

Regulation

The reduction of supply may be attributed to a number of factors. Regulatory developments have played a key role in transforming the markets over the years and in particular Basel III liquidity requirements. But liquidity ratios contained within Basel III will see banks seeking longer-term funding, reducing the amount of short-term issuance and making certain short-term deposits less attractive. Even though they are not required to comply with the requirements until 2017, many banks are pre-emptively making the changes, notes Barry Harbison, Senior Product Specialist, Liquidity, HSBC Global Asset Management, Americas. "Every financial quarter we are seeing more banks voluntarily getting their positions in place to comply with the requirements, potentially further reducing supply in the short-term space."

As the Basel III deadline looms, the progressive reduction in opportunities for treasurers will gain momentum. Banks will necessarily revisit their treatment of various deposits, and businesses will pay for those changes accordingly; deposits that do not help the banks meet their liquidity requirements will either fall well short on acceptable returns or even present negative rates. "A corporate treasurer will typically be dealing with a fairly narrow group of approved issuers," Harbison notes. "The constraints applied by regulations such as Basel III exacerbate the issue."

To a certain degree, supply in the US market has been impacted by regulatory reform of the repo market, suggests John Chiodi, Chief Investment Officer Liquidity, HSBC Global Asset Management, Americas. Stemming from the failure of Lehman Brothers, investors and issuers are now required to match their repo agreements by midday. Where previously it was an end-of-day operation this is now deemed too late for the regulators to be able to assist a stressed institution. The intention of earlier matching is well-founded but, notes Chiodi, "the fact that the majority of repos are now taken care of prior to noon leaves investors fewer options later in the day". Other US-specific issues include the reduction of Treasury issuance, possibly based on factors such as increased tax revenues or even continued dividend payments from mortgage giants, Fannie Mae and Freddie Mac (which both seek billions of dollars in cash from the US Treasury Department every quarter, mostly to pay a required 10% dividend on preferred shares that goes straight back to the Treasury).

Monetary policy

Eurozone-specific factors accounting for a reduction in supply have included the European Central Bank's (ECB) long-term refinancing operation (LTRO). This was intended to provide a liquidity buffer for banks holding illiquid assets to maintain inter-bank lending (and other loan origination). It had the unintended consequence of removing the short-term bank paper supply as banks favoured cheaper longer-term funding. However, Olivier Gayno, CIO, Wealth and EMEA Liquidity, HSBC Global Asset Management, notes that recent more favourable market conditions have meant that many banks have paid back on the LTRO "sooner than expected" causing short-term inter-bank borrowing rates to increase.

Although LTRO did take supply out of the market this is now perhaps returning. But it is not over yet. "We must keep in mind the fact that if the economic recovery in the Eurozone falters, the ECM might launch another LTRO; it is something openly being discussed," warns Gayno.

Credit concerns

Another ongoing issue being faced by investors is the credit-rating changes that have pushed some issuers outside the boundaries of approved lists for some investors. Whilst increased regulatory pressure has decreased supply, these measures have also served to improve the credit profile of some banks. In some instances this causes investors to consider investing in issuers who had previously

been removed from approved lists. The strengthening profile of some banks may see them return to favour for individual investors, says Harbison, but in the manner of Pandora's Box, now that the topic of institutional credit ratings has been raised to such a high profile, investors are "mindful" that they can and do change. The removal of an issuer from an investor's approved list – which typically contains just five or six preferred providers – may still mean it is reluctant to add it back onto the list if and when ratings improve.

In a diminishing pool of providers, the security of diversification becomes increasingly difficult. If this is the case, treasurers must consider a wider range of potential issuers than in the past. For example, they may need to seek out non-US issuers in USD, and issuers from outside the Eurozone issuing in euro, from countries with perceived strength such as Canada, Australia, the Nordics, the UK and some of the stronger Asian countries. There may be more confidence now in the credibility of ratings agencies, notes Chiodi, but exposure of treasurers to a wider market generates an increased need for market intelligence and independent credit analysis, resources and skills which are not on-tap in most treasuries.

Indirect relief

There is some light at the end of the tunnel. Some changes in money market fund supply are providing relief, albeit indirect, for some investors both in terms of supply and rates, comments Harbison. The ongoing roll out of the US Federal Reserve's reverse repurchase facility is increasing eligible investments for US money market funds; money which is thus not buying up some of the other short-term supply. And by setting a floor on overnight rates it has had a knock-on impact on the rest of the short-term markets as there needs to be some premium over the 'risk-free' Treasury rate. Treasury Floating Rate Note issuance has seen prime money market funds become increasingly interested given the reduction in supply elsewhere and given that they are considered highly liquid. Reduction in the Fed's asset purchase programme (so-called 'tapering') has also seen a gradual increase in the amount of repo collateral available, also indirectly opening up availability for investors.

Money market funds: finding the balance

In a rapidly changing market, there is an ever greater reliance on thorough credit research and market knowledge. Investors should consider the strengths of a money market fund in this context.

Credit analysis

"Credit analysis is a fundamental part of the money market fund solution," says Harbison. Its value is clear where investors experience reservations regarding the strength of the rating agencies' decisions about existing providers. But, he adds, it takes on a new level of importance with the introduction of new issuers to a portfolio. Whereas some treasurers may invest in government or treasury-type issuances to avoid all or most risk, others may see what looks like an attractive rate from an issuer with which they are not familiar but in reality could be exposing the business to more risk than they understand. "From a money market perspective, we have the capacity to offer thorough credit analysis and to find the right balance for the client, setting credit and maturity limits appropriate to that issuer," says Harbison.

Diversification

In a market environment that has in recent times demonstrated a propensity for rapid change, if a treasurer were to lose just one or two approved issuers from a typical list of five or six it still represents a significant threat to short-term availability.

For Harbison, a fund manager's capacity to analyse and offer an approved list of 100 or more issuers not only creates a broader potential supply than would be available to many (or indeed most) investors but also lessens the impact of a reduction in supply of certain issuers.

Liquidity

The Basel III liquidity requirements are pushing banks away from certain types of short-term funding. This may mean that investors face a choice between overnight deposits at unattractive rates or longer-term deposits with reduced access. "Another key strength of a money market fund is that it can offer daily access to investors, which is typically not the case for fixed term deposits or other similar products," Harbison explains. For Chiodi that means investors comparing one- or seven-day direct investments with a money market fund that can have up to a 60-day weighted average maturity.

In a constantly changing short-term investment environment, where uncertainty prevails, money market funds can offer treasurers a level of independent credit analysis, portfolio diversification and liquidity that could strike a balance between yield and protection. That is an offer the alternative short-term solutions may find hard to match let alone beat.

Barry Harbison
Senior Product Specialist, Liquidity, Americas

Olivier Gayno
Chief Investment Officer Wealth and EMEA Liquidity, France

John Chiodi
Chief Investment Officer Liquidity, Americas

HSBC Global Asset Management

For further information on our liquidity capabilities visit us at ***www.globalliquidity.hsbc.com***

A room with a view

Bert Heirbaut
Treasury Manager

Starting with a fascination for numbers, building on an aptitude for languages, rising up through the ranks and asking the right questions as he goes, has put Bert Heirbaut at the head of treasury operations for the world's largest hotels group. Seeing things from many different angles has distinct benefits.

InterContinental Hotels Group plc (IHG) is a British multinational FTSE-100 company headquartered in the UK. It is the largest of its kind in the world, measured by the number of rooms (with 687,000 as of December 2013). It has almost 4,700 hotels operating under some of the world's most recognisable brands located in more than 100 countries and territories worldwide. IHG was incorporated in 2003 as the culmination of a number of mergers and acquisitions over many years. The oldest line in the family tree can be traced back to 1777, as part of the British Bass Brewery concern. IHG reported revenues of $1.9 billion in 2013, generating a net income of $374m.

From Argentina to Zambia, the chances of finding restful slumber in an IHG hotel are pretty high. The company is the largest hotels group in the world and owns some of the most recognisable hospitality industry brands on the planet including InterContinental, Crowne Plaza, Holiday Inn and Holiday Inn Express. However, real estate is not part of its strategy; by far the bulk of the business comes from its franchise operation, accounting for 3,977 hotels, with a further 711 managed by the company but separately owned, with less than ten under direct ownership.

As might be expected with a business spread far and wide, treasury operations play a vital role in maintaining the group's day-to-day financial momentum.

The UK-based role of Treasury Manager is one that Belgian-born Bert Heirbaut has been working towards since joining the firm back in 2004 as Credit Collections Supervisor. Having realised at an early age that he had an aptitude for numerical analysis as well as the celebrated linguistic skills of a native of the low-countries, he studied modern languages and business administration at university before embarking on an early career located in the port of Antwerp as a Cost Price Accountant for Belgian logistics firm, Hessenatie. But having moved on as a Senior Collector covering Northern Europe, it was his language skills that brought him to England as Accounts Receivable Team Leader for EDS, a role he held for a couple of years before IHG offered him the collections role, the firm having moved its Business Service Centre from Brussels to the UK (the operational side of the Service Team has since moved to India).

> "It's all about understanding and planning so we can move forward as a group rather than getting frustrated on your own. It is team work,"

Having risen up through the ranks, first as a Cash Management Specialist, as a link between the service centre and the group treasury team, then as a Treasury Analyst, he now reports directly to the Group Treasurer as part of a six-strong front office treasury team. This department operates as an in-house bank for the group, with responsibility for the likes of pooling arrangements, bank balances, funding and surplus cash investments and redemptions, FX and credit analysis. The treasury team is also home to a separate Treasury Manager for the Americas, given the importance to IHG of cash management on the ground in that market. A Director of Treasury Projects rounds out the team, a role that is currently overseeing IHG's SWIFT implementation plans (which amongst other benefits will help it rationalise its banking relationships from a cash management perspective).

Over the years the emphasis has shifted towards cash management as the whole business has assumed a leaner 'asset light' model, with little in the way of a real estate portfolio on its books (a profile subsequently adopted by many of its competitors). With the change to this strategic model having largely taken place prior to the onset of the economic crisis, IHG went into the worst of times, already a lean operation. The breadth of knowledge and professionalism of its staff has contributed significantly to its well-being in a very competitive market and whilst Heirbaut takes on much of the operational treasury function he also continues his responsibilities as the Treasury Manager with a Treasury Analyst and a Treasury Dealer under his guidance.

The treasury function also assumes much of the work required to keep up to speed with regulatory change in current and new jurisdictions covered by the group. The group's recent opening of a managed contract hotel in Nigeria has seen it set up a new subsidiary in the country; Heirbaut's office now needs to keep abreast of regulatory issues that could impact treasury, such as any exchange rules and currency controls.

Keeping both eyes wide open

Maintaining a broad remit is something that Heirbaut has carried with him from the start of his career. The path he has taken has exposed him to a variety of functions and he believes this has benefitted his time at IHG, being able to understand the roots of the day-to-day operational and regulatory processes that underpin cash management and treasury in general, and indeed the impact upon and needs of his colleagues who fulfil those roles.

This level of awareness is encouraged by IHG: of the six individuals in treasury, four have risen up from its service centre. Not only does such awareness help to secure the buy-in of people at the sharp end, says Heirbaut, but it also shows that IHG supports its employees and that it is beneficial to have people who understand detailed processes and can build on that experience "to make changes for the better".

Heirbaut still gets involved in daily operations including executing FX deals. "Senior professionals need to understand what the impact of their decisions is downstream; it is important to go back to the floor to keep in touch with what is happening there," he explains.

That level of involvement extends upstream too. All major treasury projects that impact upon the group, such as the SWIFT implementation, are necessarily scrutinised by the Board and if there is any significant capital outlay the Capital Committee will need to be involved. Heirbaut says a good relationship exists with the CFO and with the legal team which tends to mean "surprises" are few and far between. "People are very much aware of what is happening so it is just a matter of finding the time and getting the priority right."

Knowing how other professionals' time is likely to be absorbed, and when they are most under pressure, ensures that the relationship is kept on an even keel. "It's all about understanding and planning so we can move forward as a group rather than getting frustrated on your own. It is team work," says Heirbaut, adding that this was never more important than during the financial crisis.

> "Senior professionals need to understand what the impact of their decisions is downstream; it is important to go back to the floor to keep in touch with what is happening there."

That said, the instability of the markets since 2008 has been managed to a degree by IHG's pre-crisis 'asset-light' restructuring programme. With franchisees and managed estates taking on the real estate element of the business and assuming that risk, IHG was (and is) free to concentrate on providing the framework for the model's success.

Spotting risk

IHG has historically adopted a "conservative" approach to risk. Interest rates on debt currently are 100% fixed, taking advantage of the current low interest rate environment. "There are no surprises," comments Heirbaut.

In terms of managing FX volatility, IHG reports in USD and the majority of its operating profit is denominated in USD (about 2,500 hotels in the group are based in the US) or USD-pegged currencies, so FX translation exposures have

historically not been a material risk. From a transactional FX perspective, IHG has sold 191 hotels since demerger in 2003 for a total of $6.2 billion. IHG hedged the proceeds whenever required. The group also returned over $9.5 billion, including $1.6 billion ordinary dividends, to shareholders in its ten-year existence as a standalone hotel company announcing dividends in USD whilst paying the majority in GBP, and again IHG's treasury ensured this risk was managed appropriately.

> "There is always something new happening – banks providing new products, new regulations coming in – you just have to keep your finger on the pulse, work out what it means for the company and then apply solutions for the better."

Counterparty risk has received a bigger focus since the economic downturn. With money market fund regulations currently "up in the air" and Basel III liquidity ratios limiting bank appetite for short-term deposits, treasury had to revisit its exposure policy. As a result, IHG has a new two-level approach to counterparty risk mitigation. Firstly, treasury can invest on a sliding scale with its relationship banks according to their external rating (it already apportions share of the corporate wallet according to commitment to IHG's syndicated facility). Secondly, Heirbaut applies six different risk measures to these banks: tier one capital; long- and short-term rating; market capitalisation; share-price volatility; and CDS levels. "We are now monitoring our counterparties on a day-to-day basis and the six measures work as a traffic light," he says. A breach of each measure gives a 'red light' and depending on how many are triggered may see closer investigation of the bank, cessation of trading or, as a final measure, the closing out of all trades.

The hospitality industry is also subject to unpredictable global elements such as weather, travel trends, natural disasters and political upheaval. "Because of the diversification of our location – we are in just over 100 different countries and territories – there is always somewhere where there might be an issue and as a company we are always concerned about those jurisdictions in terms of the impact on revenues," says Heirbaut. But because of its diversification of location it also has something of a natural hedge against such impacts because as one territory falls another rises, acting as a counterbalance. The same effect applies in terms of seasonality; it is always peak season somewhere!

Alongside day-to-day treasury ops and monitoring constant regulatory change (and implementing IHG's treasury response) the team is also about half way through the group's three-to-five year cash management roadmap. Inter-company processes are one item on the agenda with plans afoot to facilitate payments-on-behalf-of (POBO) and receivables-on-behalf-of (ROBO) solutions. These are particularly relevant for tackling the regulatory diversity and complexity of the Asian markets because they help consolidate transactions and underlying cash flows in a single bank account structure. All these projects will have the knock-on effect of streamlining and rationalising bank accounts and relationships.

The thrill of the new

The constant quest for improvement, whether incremental or entirely new, is one of the most enjoyable aspects of the job for Heirbaut. "There is always something new happening – banks providing new products, new regulations coming in – you just have to keep your finger on the pulse, work out what it means for the company and then apply solutions for the better."

> "The hospitality industry is also subject to unpredictable global elements such as weather, travel trends, natural disasters and political upheaval."

Heirbaut says he is very happy in his role and enjoys the challenge and the freedom it offers. The pleasure he derives from making new international contacts keeps him motivated and seeking out new opportunities. For anyone seeking a career in treasury he advises them to be inquisitive and to keep on top of the changes. "Once you are in the role, make sure you understand your business and all the processes in detail, and keep talking to people; there is always someone who knows the answer. Use your relationships with the banks because they have a lot of product specialists. It's all about finding the right people, asking the right questions and understanding the impact."

As part of a major global hospitality group with hotels in some of the finest locations anywhere, Heirbaut has but one destination in mind when the offer of an all-expenses paid trip comes through: he'll be in Brazil watching Belgium win the 2014 FIFA World Cup. "Even treasurers have dreams!" ■

How to optimise your national and global cash management

Many companies could make their cash management much more effective, clearer and more cost-efficient if they consistently used all of the measures and instruments which are available. To help them do this, Commerzbank's Corporate Banking division has developed a five-point programme for cash management optimisation in Germany and around the world.

The five-point programme covers all aspects of national and global cash management and flags up concrete potential improvements. It is then implemented at the company in question in conjunction with Commerzbank's cash management specialists.

1. Reduce complexity

The Single Euro Payments Area (SEPA) offers companies potential savings and efficiency gains if they make the relevant adjustments. Using direct debits, optimising cheque handling or implementing virtual accounts and payment factories can help firms to reduce complexity and costs substantially.

2. Improve liquidity

Many companies are still far from making full use of their internal financing resources. Long-term capital commitment, one of the main drivers of internal financing, is caused, for example, by generous payment deadlines or substandard arrangements for invoicing and reminders. As part of their comprehensive approach to optimising the commitment of working capital - the cash conversion cycle - cash management experts start analysing DIO (days inventory outstanding), DSO (days sales outstanding) and DPO (days payable outstanding).

3. Overcome borders

These days, internationalisation is a must for virtually every company. However, crossing borders often means venturing into unknown territory where different laws apply and cash management costs increase. With its international solutions for optimising both interest and liquidity and for realising payment factories, Commerzbank helps firms to overcome cash management borders. Commerzbank also provides local support for companies abroad by means of relationship managers at its branches around the world and a cross-border client relationship model.

4. Optimise interest

Any treasurer who manages several corporate accounts will be familiar with this situation: overdraft charges are payable on one account while another is in credit but earns little in the way of interest. Commerzbank's cash pooling service can offset your debit and credit balances which attract interest and use all the options for short-term liquidity investments and borrowing by means of focused volumes. In this connection, experts also examine whether – and when – it makes sense to take a cash discount.

5. Enhance transparency

Anyone who wants to make sound cash management decisions needs reliable, timely information for example, about current financial positions as well as details of interest and exchange rates. Credit ratings for potential business partners and country-specific risk assessments can also be invaluable when operating both at home and internationally. On top of all this, up-to-date information about national specifics and both legal and tax requirements is essential in the context of international cash management. Commerzbank's cash management specialists provide all of this.

For further information, please visit
www.commerzbank.com/corporatebanking

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The bank at your side

Mexico: trading up

Mexico's close historic trade links with the US have allowed it to grow alongside its economic juggernaut of a neighbour. However, the Latin American country still faces several challenges to unleashing its full growth potential. The question now is whether it can overcome these roadblocks and become a haven for MNCs operating in the region.

The birthplace of several advanced civilisations such as the Maya and Aztec, Mexico has a rich and colourful history. Conquered and colonised by Spain in the 1500s, it became an independent nation some 300 years later. Today, the country has a GDP of $1.18 trillion and is Latin America's second largest economy, after Brazil. The service sector makes up the lion's share (60%) of Mexico's free market economy, with industry (37%) also contributing significantly to the economy. Following the 'Mexican Miracle' of growth between the 1940s and 1970s, the country's economy has slumped and recovered several times, but has never matched the consistent growth achieved during its golden period in the mid-20th century.

In 2013 Mexican economic growth fell to 1.1% – the slowest the country has seen since the recession of 2009, and well below the 3.9% it recorded in 2012. One key factor that has played a part in Mexico's sluggish growth is the slowdown in the US manufacturing sector. With almost 80% of its exports going to the US, changes in economic conditions north of the border do not take long to filter down to Mexico. Even the weather in the US can affect Mexico's economy, according to Mexican central bank Governor Agustín Carstens.

However, while it is liable to feel the impact of negative developments in the US, Mexico's close ties with its influential neighbour have also contributed to the Latin American country's relative macroeconomic stability. Inflation in Mexico has not topped 6% since 2001. This stability is also reflected in the movements of the free-floating Mexican peso (MXN). For five years the MXN/USD exchange rate has hovered largely between 12-14.

Marco Oviedo, Chief Economist for Mexico at Barclays, sees the MXN (which is not subject to any exchange controls) maintaining its steady course for some time to come. "As the US continues to reduce the monetary stimulus, we believe the peso will be stable compared with the rest of the emerging market currencies. Long-term the MXN has followed the USD, and if the dollar strengthens, the peso will strengthen with it. We are expecting the MXN to close this year at 12.95, implying that it will hover around 12.90-13 during the year," he says.

Another factor contributing to the country's stable exchange rate is the North American Free Trade agreement (Nafta), signed by Canada, Mexico and the US 20 years ago. "Nafta has been key to Mexico's currency stability," says Juan Pablo Cuevas, Head of Global Transaction Services for Latin America and the Caribbean at Bank of America Merrill Lynch. "It has also made Mexico's banking sector more competitive and led to the development of a host of new banking products and services between the three countries." Certain practices can only be carried out between Nafta members, too. Cross-border sweeps for cash concentration between resident and non-resident entities, for example, can only be conducted within the bloc.

Key facts

Population: 120.8 million*

GDP per capita 2013 (US dollars): $10,629.88**

GDP percent change 2013: 1.1%**

Current account balance 2013 (US dollars/ billions): -22.33**

Inflation (average consumer prices) percent change: 3.804 (2013)**

Ease of doing business (2013) rank: 53 out of 189 globally*

Corruption perceptions index (2013) rank: Joint-106 out of 175 globally***

Sources:
**World Bank*
*** IMF World Economic Outlook April 2014*
****Transparency International*

Mexico is also negotiating with the US and Canada as to how the Nafta members can fit into the Trans-Pacific Partnership (TPP). If the three North American countries become part of the trade agreement, which was originally signed in 2005 by Brunei, Chile, New Zealand and Singapore, it could forge stronger trade links between them and the signatories on the other side of the Pacific.

Political credibility

Closely aligned to Mexico's economic stability is a political credibility that is starting to inspire confidence, both domestically and further afield. "This is the best political environment since Mexico became a modern democracy and we saw a lot of reforms approved last year," says Barclays' Oviedo. "Though the political parties will begin to move on with their own agendas before the 2015 elections, we don't have radical politicians in the congress, and the political conditions are very positive right now," he says.

Mexican president Enrique Peña Nieto of the PRI (Partido Revolucionario Institucional) party, has instigated a number of aggressive reforms (such as the establishment of an autonomous federal authority to challenge the dominance of telecommunications giant Telmex, and a banking reform initiative to make lending easier) to encourage economic growth through increased competitiveness since he assumed office in December 2012. Peña Nieto even featured on the cover of Time Magazine in February – further evidence of his standing as an economic reformer.

Despite the determination of its leader and the many opportunities offered to Mexico through collaboration with its neighbouring economies, the country still faces significant challenges to growth.

A country divided?

In a research paper, entitled "A tale of two Mexicos", management consultant McKinsey & Company said the country's two-speed economy, in which large companies are highly productive while smaller firms have their output stymied by red tape, is acting as a brake on Mexico's growth.

"A modern, fast-growing Mexico, with globally competitive multinationals and cutting-edge manufacturing plants, exists amid a far larger group of traditional Mexican enterprises that do not contribute to growth," says McKinsey in the report. "These two Mexicos are moving in opposite directions. The largest companies are raising productivity by an impressive 5.8% a year, while the productivity of small, slow-growing enterprises is falling by 6.5% a year. And with employment growing faster in the traditional Mexico, more labour is shifting to low-productivity work."

Mexico's cash-driven 'informal economy' is an additional challenge here. "Thirty percent of Mexico's total economy continues to be informal, and this portion of the economy runs entirely through cash," says Barclays' Oviedo.

This large informal economy is a problem for Mexico in the lost tax revenue and social security contributions it represents. Indeed, some analysts believe it is holding the nation back from fulfilling its economic potential, although to what extent is unclear. What is certain, however, is that this portion of the economy – which accounted for 60% of total employment in Mexico in 2013 – is of huge significance to the country.

Interestingly, while its large informal economy relies on cash as a means of exchange, Mexico has a sophisticated payments network relative to its Latin American contemporaries to support its larger businesses.

Payments infrastructure

The central bank, the Banco de México (Banxico), has driven the development of the country's payments system. "Mexico's payments infrastructure has been undergoing an incredible evolution over the last ten years," says BofAML's Cuevas. "The Banco de México has made a concerted effort to improve the system, trying to get rid of paper and move towards electronic payments. They have also created a very efficient market for the compensation of high- and low-value cheques," he says.

> "Mexico has one of the more efficient and developed payments systems in the region, and it is constantly improving."
>
> Simon Shingleton, Regional Head of Multinationals Sales – Global Payments and Cash Management, Latin America, HSBC

The Sistema de Pagos Electrónicos Interbancarios (SPEI) is Mexico's real-time gross settlement system, and is owned and operated by Banxico. SPEI operates on a T+0 basis. In 2012 there were 172 million SPEI transfers with a combined value of almost MXN 200 billion – an increase of 55.3% in terms of volume and 11.3% in value on the previous year.

New regulation, coming into effect in September 2014, will require domestic priority payments on SPEI to be closed within five seconds (the limit is currently 30 seconds), effectively enabling instantaneous same-day transfers to be made.

The Centro de Compensación Bancaria (CECOBAN) is a compensation centre owned by a consortium of banks in Mexico. It processes interbank cheques, credit transfers and direct debits in the country. CECOBAN operates on a T+1 basis.

"Mexico has one of the more efficient and developed payments systems in the region, and it is constantly improving," says Simon Shingleton, Regional Head of Multinationals Sales – Global Payments and Cash Management, Latin America, at HSBC. "Like the rest of Latin America, there is still a lot of cheque usage, especially for low value payments and in the industrial and service sectors, but electronic payments are on the up and same-day transfers are being heavily promoted by the central bank," he adds.

Cheque usage remains prevalent, accounting for 108 million transactions in 2012, although it is steadily decreasing (from 165 million and 150 million transactions in 2004 and 2008

Mexico				
Payment statistics	Millions of transations			% change
	2004	2008	2012	2004-2012
Cheques	165.4	150.0	108.2	-35
SPEI transfers	4.53	41.71	171.9	3795
ACH credit transfer	12.7	22.36	127.9	1007
ACH direct debits	2.38	21.40	15.7	660
Credit card payments	N/A	387.1	383.8	-1 (2008-2012)
Debit card payments	N/A	414.0	752.2	82 (2008-2012)

respectively). Both MXN- and USD-denominated cheques can be drawn on Mexican banks.

Liquidity management

Corporates operating in Mexico have almost the same range of liquidity management services at their disposal as their counterparts in Europe and the US. Cross-border cash concentration is allowed in Mexico, as is zero-balancing, although with the latter corporates must keep different currencies in separate structures.

Neither notional pooling nor inter-bank cash pooling, however, are permitted in Mexico. In order to work around this restriction, some banks allow their clients to sweep MXN or USD out of Mexico into a multi-currency notional pool abroad, with the funds being swept back the same day. This arrangement effectively allows an entity to conduct notional pooling without being domiciled in Mexico.

> "Despite concerns over its sprawling informal economy and the continuing problem of security, Mexico's sound economic growth and stable currency make it an attractive regional base for corporates."
>
> Simon Shingleton

"Besides notional pooling, all the liquidity management services a corporate would expect to have in Europe, Asia and North America, are available in Mexico, and increasing numbers of MNCs are looking to centralise regional operations in the country," says HSBC's Shingleton.

From May of this year, banks in Mexico are required to support mobile payments, and in September, mobile payments will be allowed beyond normal business hours, from 6am to 1pm, 365 days a year.

Furthermore, a financial reform package consisting of 34 financial and banking laws was published in January 2014. The new laws are intended to strengthen banking regulation and the legal framework by guaranteeing collection, increasing competition and enhancing transparency in the sector. Standard and Poor's has said the reforms could ultimately lead to a higher banking penetration in Mexico in the long run.

The largest banks in Mexico (by total assets) are BBVA Bancomer (part of BBVA Group), Banamex (part of Citigroup), Banco Santander México (part of BSCH Group), Banco Mercantil de Norte (part of Banorte) and HSBC Bank Mexico. Seventy-five percent of banking assets in Mexico are foreign owned; Banorte is the only private bank in the country that remains majority owned by domestic shareholders.

Useful information for treasurers

In addition to its fellow Nafta members, Mexico has free trade agreements in place with Bolivia, Chile, Columbia, Costa Rica, El Salvador, the EU, Guatemala, Honduras, Israel, Japan, Nicaragua and Uruguay. Mexico has a free trade agreement on cars with Brazil. Imports are subject to VAT of 16%, or 11% for goods imported into border regions. Certain products, including electricity, are subject to an export tax of 25-50%.

The federal corporate income tax rate in Mexico is 29%. This will fall to 28% in 2015. Withholding tax is not imposed on dividends.

Demand for bank credit is rising in Mexico. In April, Banorte, the country's largest domestically owned bank, reported a 27% rise in first-quarter profits, which it said was partly the result of increased lending activity. The bank said its loan portfolio grew 12% over the year to MXN405 billion, with consumer loans up 17% and loans to SMEs up 20%. And this trend could well continue as a result of Peña Nieto's banking reform bill, which has the increase of credit provision to the private sector as one of its key goals.

Though nurturing private sector growth through banking reform has been warmly welcomed by many Mexicans, others feel Peña Nieto's reforms have not addressed one of the biggest problems facing the country: organised crime.

Security concerns

In fact, security, particularly the ongoing problems with drug cartels, remains a challenge for Mexico. Mexico's murder rate was 21.5 per 100,000 people according to a United Nations report published in April, and around 85,000 people are estimated to have died in drug-related killings since 2007. Barclays' Oviedo says that while many have lauded current government's economic reforms, there has been less enthusiasm over its approach to dealing with organised crime. "Security is the elephant in the room in Mexico," he says.

"Fighting the drug cartels was one of the main pillars of the previous administration, but since Peña Nieto came into office the government's strategy on tackling the issue has not been particularly clear or coherent. Kidnappings and extortion have increased in certain areas of the country, although assassinations and killings have fallen on the whole. There are still a lot of security issues that need to be addressed."

Reactivation of confidence

Despite concerns over its sprawling informal economy and the continuing problem of security, Mexico's sound economic growth and stable currency make it an attractive regional base for corporates, and HSBC's Shingleton says there is a strong argument in favour of centralising treasury operations in Mexico.

"Treasurers can come with confidence into the country," says HSBC's Shingleton. "From a liquidity management perspective, it makes sense to consider Mexico as part of a North American or global solution, as you can move money into and out of the country freely, which is not possible in some other Latin American countries. Mexico is very much geared up to work with MNCs, and many are looking at setting up SSCs there," he adds.

In April Mexico's economy showed signs of picking up after its sluggish 2013 and beginning to 2014. Inflation fell from 4.48 to 3.89, while the consumer confidence index rose from 84.5 to 88.8, in what Banxico Governor Agustín Carstens described as a 'reactivation' of the economy. Now the question is whether MNCs can learn to share Mexican consumers' confidence in the nation's economy. ■

Visions of risk

Managing threats to liquidity and financial risk in a volatile economy are all part of the treasurer's remit. Understanding risk has never been more important to avoid losses. Treasury Today looks at two contrasting but effective modes of risk management.

The world often turns to economists when 'the finances' aren't going too well. But sometimes it seems that the professional requirement for this breed of expert is to predict what will happen and then to explain why it didn't happen the way they predicted it would.

In fairness, risk 'prediction', and thus risk management, can be a very difficult task to undertake, even for trained experts. Financial risk management can be qualitative or quantitative but either way it is about identifying, assessing and addressing sources of risk. For treasurers without access to a lifetime's accumulated knowledge and endless resources, the need is to shift the focus and response away from the 'big picture' of uncertainty towards market risks that are potentially damaging to their own organisations.

Part one: watching the numbers

In doing so there is still a need to find the balance between breadth and depth but trying to remove all uncertainty is not necessarily the right approach, claims Yuri Polyakov, Head of Financial Risk Advisory, Lloyds Banking Group. He believes that businesses must establish an "appropriate degree of risk tolerance" and then focus on the major adverse scenarios rather than getting too caught up in mitigating the risk of all rare market moves.

Of the tools that are available, Polyakov says the focus tends to be on hedging strategy and accounting rather than risk evaluation. If a business wants to understand how much its cash flows will be impacted by FX risk, commodity risk, interest rate risk or inflation risk, for example, he states that there is no perfect tool yet available that can achieve that.

There is evidence to this effect. Procter & Gamble talked at the EuroFinance conference in Barcelona last year about this problem. Its spokesman, Director of Global Treasury, John Byma, took delegates through the process of building its own risk toolset, driven by the absence of anything on the market to help. But P&G is a company with assets of $139.26 billion (2013)

and has the resources to undertake such a project. At the same conference, Jennifer Ramsey-Armorer, Director of Treasury for Canadian communications firm, BlackBerry, talked about how FX volatility represented a huge risk to its operations and that because no solution existed to predict this risk it had to call upon a neighbouring University for help. It ended up with an Excel spreadsheet macro that could handle the calculations.

Methodologies

For better or worse, the solution for most treasurers without access to a risk department or huge resources still lies in the hands of their banks. As long as both bank and client agree on the methodology and, more importantly, the assumptions that drive the process, the results can be entirely credible, says Polyakov. For him, the methodologies are pretty simple anyway, "even though people can spend ten years or more talking about modelling the markets".

He divides the process into three different steps. Step one is to model market uncertainty. "There are plenty of tools, methodologies and accepted algorithms that allow you to model FX rates, interest rates, commodity risk and so on – it's not rocket science; there is nothing proprietary here."

The key is not to try to predict specifically where the market will go, but to try to broadly understand where the market could go. The need is thus to uncover trends around each risk element (FX, interest rate, commodity price and so on) and the relationships between the different risk forces that act upon these elements, whether by studying current market implications or historical data.

Having made an assumption and modelled market behaviour around it, the next step is to consider the company's business plan in the context of this model. If market uncertainty has been simulated and the company knows, for example, exactly when cash is coming in and in which currencies, and what its debt payments will be, it then becomes a simple spreadsheet exercise to generate an answer with a plus/minus range of acceptability, says Polyakov. "But if you change your assumptions, the results may change. This is where step three – stress-testing – is very important."

By repeating the process with different assumptions it will be seen that some of those assumptions will have very little impact on results and some will have a huge impact. Those that do not have much impact are not a problem. "But if you realise that certain trends in a particular FX market, for example, have a big impact on your results, then that is where you should spend your time."

Finding the areas of most impact will inform the treasurer's operational activities in terms of hedging, for example. "But before you run off to hedge something, you should ask yourself if you can operationally change something to create the same level of risk mitigation," he advises. It might be, for instance, more provident to reconsider the contract currency in which your buyers are operating. From a shareholders perspective at least, it is always better to optimise the business model before hedging.

Black swans

In all risk analyses there are external factors that cannot be predicted but which can significantly impact the markets. Major terrorist attacks, the outbreak of war or civil unrest, financial meltdown, geographic catastrophe: all are seemingly impossible to factor into the equation but all could happen. Can a business realistically be prepared?

So-called 'black swan' events – those that deviate significantly from the norm and which are very difficult to predict – were first introduced as a concept by Nassim Taleb in his 2001 book 'Fooled by Randomness'. Taleb has since progressed his theory and now argues that as we have seen so many different black swan events in recent times it is possible to imagine and draw up a list of almost every possible significant incident. We have no idea whether any of these events will happen or not, nor when, just that they could; this is Taleb's concept of the 'grey swan'.

"People are much more aware of the breadth of scenarios that need to be evaluated, but they need to be very clear that whatever the level of confidence in a prediction, it is not the worst case scenario; things that are worse can and will eventually happen," says Polyakov. The only sensible response to this, he says, is for a business to have enough liquidity on its balance sheet to survive unknown and major disruption. This begs the question for how long would the business need to be completely disrupted before it became unviable, the answer to which can be found in the business model.

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Ultimately, a large liquidity buffer is the only thing that will help if things become really disruptive. "You can manage risk all you want, but at the end of the day it is that unknown element, which can happen, that will hurt most," warns Polyakov. The size of liquidity buffer depends on the business. Moody's says Microsoft has $77 billion in cash; its arch-rival Apple is believed to be sitting on $147 billion. These are extremes, but all companies should take a holistic view of where their cash is and know that when calculating how much it needs the answer should be "a straightforward function of how long it wants to survive".

Part two: watching the banks

There is no return without risk. And yet, as far as the banking system is concerned, the regulators seem to believe that their objective is to remove risk. They do things like applying higher levels of taxation and demanding ever more capital and liquidity against failure so that the risk shifts to another part of the industry. Then the regulators inspect the new source of risk and find ways of regulating that, forcing it somewhere else in the system. And so it goes on. "The logical extension of this risk management strategy is that we push risk to where we can no longer see it, because if we can't see it we can't do anything about it. That will not make the world a safer place."

These are the words of Avinash Persaud, Emeritus Professor at Gresham College, a former Governor of the London School of Economics and Chairman of investment analysis firm, Intelligence Capital and London investment bank, Elara Capital. With years of experience in the field, Persaud knows that almost any activity can generate risk; it cannot be removed entirely and so the real question, he says, is how well it is managed and how easily its effects are absorbed. Banks may be regulated but they can still fail.

As such, when selecting a bank, as part of the due diligence process, a treasury should be aware of a number of indicators that could show that its prospective partner is heading in the wrong direction. The interesting factor is that none of these indicators require detailed numerical analysis.

Certainly for a treasurer seeking shelter from the ravages of recession, Persaud highlights three key areas of financial risk that must be known about any banking partner: its level of diversification ("concentration of lending in any one sector is a sure sign of risk"); leverage ("the less leverage a financial institution has, the safer it is"); and liquidity ("the shorter a bank's funding, the more vulnerable it is"). But beyond the purely financial there are a number of risk factors that he believes treasurers can use as a measure of a bank's susceptibility to failure. The first of these relates to the behavioural element of banking.

Remuneration

With politicians talking volubly about bankers' remuneration packages, many may feel a little uncomfortable about governments getting involved in private sector pay. In this instance, perhaps this view is misguided. "Everything that happened in the financial crash was incentivised to happen," comments Persaud. The lack of a requirement to provide capital adequacy against certain contracts meant banks were not discouraged from putting them off balance-sheet, he explains. Bankers were thus effectively encouraged to swap credit risk, for which they had a capital adequacy requirement, and take in liquidity risk, for which they didn't. "The danger of having stratospheric levels of pay in banking is that it creates a tendency for lottery-style risk-taking."

Why does anyone enter a lottery when most people know they have a low chance of winning? The answer, says Persaud, is because there is an opportunity, however small, of "life-changing" results. Before the crash (and some may argue after it too) banks would pay many of its staff life-changing levels of bonus. Where such opportunities for individuals exist it creates a risk-taking culture that steps well beyond the norm. Understanding a bank's remuneration structure can give clues as to its risk-taking culture.

In a competitive environment a certain degree of risk-taking seems inevitable but the regulators have talked a lot about increasing competition in the financial sector, notes Persaud. "The problem is that competition seems to have a trade-off with stability." The banks that fail, he observes, are often the "challenger banks". For example, before it imploded, BBCI was offering much higher rates than other banks. The Icelandic banks expanding into Europe similarly went too far too soon, as did the UK's Northern Rock – all failed spectacularly by trying to break into new markets. "Aggressive competitive behaviour is often a sign of a bank that is going to run into trouble," he believes.

Aggressive or not, all banks like to talk about how customer-focused they are. A bank that has a deep customer franchise that exists because of long-term client relationships will encourage a broad connection across the organisation, says Persaud. "How often does your bank introduce you to other parts of the business? The more your bankers try to broaden the relationship, the more it is a sign that they are investing in that client franchise – not the individual banker's franchise."

Relationships

Internal and external relationships play a key role in Persaud's proposal. "There was a time when it was thought by some that there were too many bankers and insiders on the Boards of banks, that they were too cosy," he notes. The thought that people with no preconceptions about banking could steer a safer passage rose to prominence on the back of a belief that these people would question every move. When the crash happened it was discovered that there were many such individuals on Boards, he says. This suggests they weren't as inquisitive as they should have been. The recent case in the UK of the Co-operative Bank which was steered gracelessly into a wall by its CEO who was, it transpired, untouched by banking experience, serves to highlight the need for knowledgeable guidance.

But some banks are better survivors than others and another indicator of robustness is how risk is treated at the highest level. "There was a tendency for banks in the run up to the crisis to amalgamate their risk committees with their audit committees," notes Persaud. The problem is that the audit function is very different to risk management: audit is more of a box-ticking exercise (albeit a complex and demanding one) whereas risk management is not. "The more you merge audit and risk, the more risk becomes a box-ticking exercise," he states, adding that this is a dangerous state of affairs.

If internal relationships with Boards and clients are very important for a bank, the relationship it has with its regulators is vital. Pre-crash, many banks were "openly disdainful" of their regulators, says Persaud. Post-crash it was the regulators, alongside the tax-payer, that saved some of these banks. "You can still sense the disdain, but regulators are human beings too; they don't like being insulted."

When the regulatory authorities were considering whether to save Bear Stearns and Lehman Brothers – two institutions that had "well-articulated disdain" for government regulators – he suggests that "there was no love lost" when they were allowed to fail. "There were other institutions arguably in similar positions that were rescued by regulators because they had a better relationship with their regulators," he adds, further commenting that some of the huge fines meted out to banks today may have more than a passing connection with the state of their relationships. For a bank, attacking the regulator in public is seemingly ill-advised because if ever that bank is at the mercy of its regulators, the strength of the relationship counts more than it would like it to.

The key message to take from all these points is that a treasurer can manage risk using quantitative and qualitative approaches, and that although clearly the numbers have a lot to say if crunched intelligently, when assessing counterparty risk there are many other factors worth considering that can tell so much more. By studying all these elements and understanding the relationships between the different risk forces it is possible to make more informed judgements about future events – and that is as much as anyone is able to do. ■

Managing emerging market liquidity

Expanding in emerging markets may offer businesses unprecedented opportunity for growth, but most making that move know that there are increased risks too which, if left untended, could impair their bottom line. What can be done?

Amit Agarwal
EMEA Head of Liquidity Management Services

Dimitrios Raptis
EMEA Head of Market Management, Liquidity Management Services

Emre Karter,
Central and Eastern Europe Cluster Head, Treasury and Trade Solutions

Whilst some challenges facing corporate treasurers are similar to those experienced in developed markets, emerging market volatility tends to be more intense, with heightened political and market risk. And depending upon which market(s) a multinational company (MNC) is operating in, it may also find that the regulatory environment is subject to change at short notice, with restrictions on free flow of liquidity and capital being quite typical.

Risk factors

Much of the emerging market growth over the past few years has been fuelled by significant in-flow of capital from developed markets in the form of portfolio and foreign direct investment (FDI). With the tapering of quantitative easing (QE) in the US, emerging market liquidity has been put under pressure. In turn, this is impacting local currencies' exchange and interest rates as many investors head back to safety.

Turkey provides an interesting example here, says Amit Agarwal, EMEA Head of Liquidity Management Services, Citi, since the country has certain particularities such as a current account deficit, a slowdown in domestic demand, and recent political uncertainty. In an attempt to stem the decline of Turkish Lira, the country's central bank raised its benchmark rate by a significant 400 basis points earlier this year. But Turkey is not alone – other emerging markets such as South Africa, Brazil, India and Indonesia are also facing similar currency pressures. This volatility in currency and interest rates entails risks for international corporates with a local presence and needs to be managed carefully at Group level – on a country-by-country basis. After all, while emerging markets are often spoken about en masse, they are actually very idiosyncratic. Treasurers therefore need to monitor and adjust their liquidity strategy, in line with the specific risks each operating geography presents, in order to manage counterparty and liquidity risks effectively, while also optimising excess balances.

Tapering also accounted for pressure on local currencies in Russia and Kazakhstan in the beginning of 2014. In response to a gradual devaluation of Russian rouble that started in January 2014, the National bank of Kazakhstan announced a sharp devaluation of Kazakhstan tenge on 12th February, resulting in significant tenge short-term rate volatility. The move also saw major local players as well as consumers switching to foreign currency says Emre Karter, Central and Eastern Europe Cluster Head for Citi's Treasury and Trade Solutions.

Although a growth market for many multinationals, Russia is facing a number of challenges on the back of a slowing economy, notes Karter. "More needs to be done in terms of structural reforms and infrastructure investments for the economy to perform at its potential; the latest geopolitical issues only compound the growth challenges." This combination of depreciation of the Russian rouble triggered by tapering, macroeconomic challenges and geopolitical tensions, led policy makers to hike base rates by 150 basis points in March 2014. Treasurers of multinationals operating locally should therefore consider the possibility of an increased cost of funding and intensified FX risk. Against this backdrop, revisiting intercompany arrangements and liquidity projects could also be extremely beneficial, points out Karter.

Liquidity challenges

The kind of interest-rate volatility seen in Turkey, Kazakhstan, and Russia, for example, is a persistent risk for businesses engaged with emerging markets. On the other hand, investors can take advantage of these spikes as long as they have flexibility in their short-term investment approach. But, as Dimitrios Raptis, EMEA Head of Market Management, Liquidity for Citi, points out, many corporates may have funding needs in local currencies or are strategically running short positions utilising credit facilities locally. As such, rate rises will immediately impact the interest expense on their balance sheet and will inevitably imply a higher cost of doing business locally. At the same time, the devaluation of positive balances that may participate in notional pooling structures will also have an adverse impact on the total efficiency of the arrangement, diminishing the overall pooling benefit.

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An additional common liquidity challenge for corporates expanding in emerging markets arises from the multiple banking relationships and accounts that they need to open and manage, since very few banks have a consistent geographical presence across all countries. The challenge is that these scattered pockets of cash may create fragmented positions and idle balances.

Another common pain point for treasurers is the level of liquidity they need to commit locally because of the lack of an easily accessible or efficient local clearing system. Fortunately though, central banks and governments in emerging markets are becoming increasingly aware of this challenge. In Russia for instance, says Karter, a number of efforts have already been made by the regulator to optimise the local payments infrastructure, starting in 2008 with the introduction of a real-time gross settlement system (RTGS) for rouble transactions. Despite these developments, however, "an MNC treasurer still would need to keep a close eye on the allocation of intraday liquidity as the majority of settlements in local currency are still done in the batch system." This results in a transaction initiated in the morning reaching a beneficiary much later in the day. Under these circumstances, accurate forecasting and liquidity optimisation "takes on a new level of importance," Raptis notes. However, maintaining full visibility over cash under such circumstances is difficult, if not impossible. So what is a treasurer to do?

As a company expands into an emerging market, and that market becomes more important to it, there comes a time when it should revisit the organisational structure of its treasury, advises Agarwal. Increasingly, for global MNCs, the combination of a centralised and regionalised structure is adopted, where the head-office is responsible for policy and the regional treasury centres enact those policies operationally. The location of regional centres is thus critical. A strong presence in emerging markets will require representation in those territories to take care of funding the business on the ground, forecasting, identifying risk exposures and co-ordinating local bank relationships.

Whether centralised or de-centralised, without a firm grasp of all the relevant local regulatory requirements (and indeed cultural indicators) it is not possible to devise a truly effective strategy for each location. "This is where the role of the banking partner with a long-standing physical presence in each emerging market becomes critical," states Raptis.

Solutions

Even in a fully-centralised treasury environment, the near-constant state of market and political flux in certain countries demands strong local cash and liquidity management. Full cash visibility and the capacity to consolidate and fully fund in-country (local currency flows) are essential, but if a treasurer is able to move liquidity it should be incorporated into the company's regional or global liquidity pools. Of course, where exchange controls are in place, technological capabilities can be limited by regulatory requirements and would eventually force the implementation of local or hybrid solutions.

One such option here is to centralise liquidity locally with a large international bank. "Companies tend to operate with various local banking partners, because some local needs can only be met by these providers," says Karter. "From a risk management and liquidity perspective, using proprietary bank liquidity management tools enables companies to centralise liquidity on an overnight basis with their relationship bank in that country." Treasurers should also consider domestic cash pools, where permissible, and look at interest-optimisation techniques. In respect of the latter, a number of banks, including Citi, offer quasi cash-pooling options that benefit grossed long and short balances (a true notional pool enables balance-sheet netting which is not permitted in many emerging market jurisdictions).

Where notional pooling is allowed and trapped cash is not an issue, corporates should be looking for a multi-layer, cross border concentration structure integrated with regional pooling mechanisms that are scalable and can support the organisation's growth plans. This means that the solutions should be able to include as many currencies as possible and entities incorporated in as many jurisdictions as possible, Raptis advises. By incorporating surplus balances of emerging markets' currencies into a notional pool it could enable the pooling owner to capitalise on the interest increases and effectively offset overdrafts in low yield hard currencies. However, he explains, this model must be delivered by the bank as a "fully integrated end-to-end solution" able to incorporate elements such as local AR/AP, short-term investments and any third party banks and also consolidate visibility from different locations and for different pockets of balances. A key parameter is the customisation of the integrated investment solution that should optimise treasurers' excess liquidity without the need to go longer on tenors. Such a solution will minimise the risk for the corporate and will enable them to capitalise on interest rates spikes.

Structural considerations

There are certain structural solutions that can also help to optimise emerging market liquidity, notes Agarwal. Where transferring liquidity between subsidiaries can potentially trap cash, establishing a netting centre can help by accelerating or delaying the transaction as appropriate, alleviating the volume of trapped cash. Similarly, if a business with a manufacturing entity in a country with currency restrictions procures significant volumes of material from suppliers in developed markets, it may create a procurement centre in a developed-market location. This enables payment acceleration coming out of the manufacturer and slower payment to the suppliers.

However, if the supplier is located in a 'trapped-cash' country, it may benefit the buyer to pay more quickly. By offering shortened payment terms, it may be possible to negotiate lower procurement costs, explains Agarwal. The reverse of this is to offer longer-terms to buyers, potentially facilitating increased sales revenues. Alternatively, if a sales entity buys from a manufacturing entity, where both are part of the same group but located in a currency-restricted geography, a re-invoicing centre located in a developed country may be used to leverage inter-company flows.

These are just some of the solutions available to help treasurers manage liquidity in an emerging market context. The international banking infrastructure necessarily sits astride all cash flow movements, even if an in-house bank is in place. As a partner in the journey "towards optimised liquidity", Agarwal believes that a major international bank "with an extensive footprint in the emerging markets" has an important role to play. Indeed, given the risks and opportunities found in these markets, arguably the role of the bank is essential.

Key trends in bank regulation

With the implementation of Basel III, Dodd-Frank and EMIR now firmly underway, banks and their regulation-weary corporate customers will be hoping that the structural upheaval that began in the wake of the last financial crisis is drawing closer to a conclusion. As the dust begins to settle, we ask industry experts what the new regulatory landscape will mean for corporate treasurers.

In the aftermath of the recent financial crisis, G20 leaders met in Washington DC to agree a blueprint for reform of global financial markets. The regulatory burden on banks has grown exponentially in the time that has passed since then and it is affecting not just the banks themselves but, increasingly, their corporate clients too.

The list of what a corporate treasurer needs to know about bank regulation is a long one, but there are a handful of distinct themes that dominate. This article, although far from exhaustive, will shed some light on these themes by sketching a broad outline of the emerging regulatory landscape and the key implications for corporate treasury functions.

Bank finance

A change in both the cost and availability of bank finance is undoubtedly the most significant development where treasurers are concerned. Ever since the Basel Committee on Banking Supervision announced tougher capital and liquidity rules, banks have been warning that customers will face more costly credit – or perhaps find it difficult to access altogether – as a result. "Basel III makes us more thoughtful of who the end holders of assets should be, in whatever form," explains Nick Burge, Managing Director and Head of OTC Clearing at Lloyds Bank. In the post-Basel III world, holdings of longer-dated capital-heavy assets will continue to shift away from the banks to institutions such as insurance companies and pension funds who want longer-term exposures. Banks, meanwhile, "continue to act as arrangers between borrowers and end investors and to provide more of the shorter-term, revolving facilities that banks are best placed to manage," Burge adds.

There are signs that the banking community was not exaggerating when it claimed that the Basel capital requirements – a risk-weighted capital ratio of 4.5% plus an

additional buffer of 2.5% – would have a sizeable impact on longer-term business lending activities. In Europe, despite a prolonged period of ultra-low interest rates, bank lending has remained weak while corporate bond issuance – thanks also in part to unconventional monetary policies – has soared to record levels. As companies continue to flock to the capital markets we are already witnessing a shift in the composition of the corporate debt stack. In Europe, bonds accounted for 18% of the funding mix in the three years before the crisis. In the three years since 2011, they have averaged 31%.

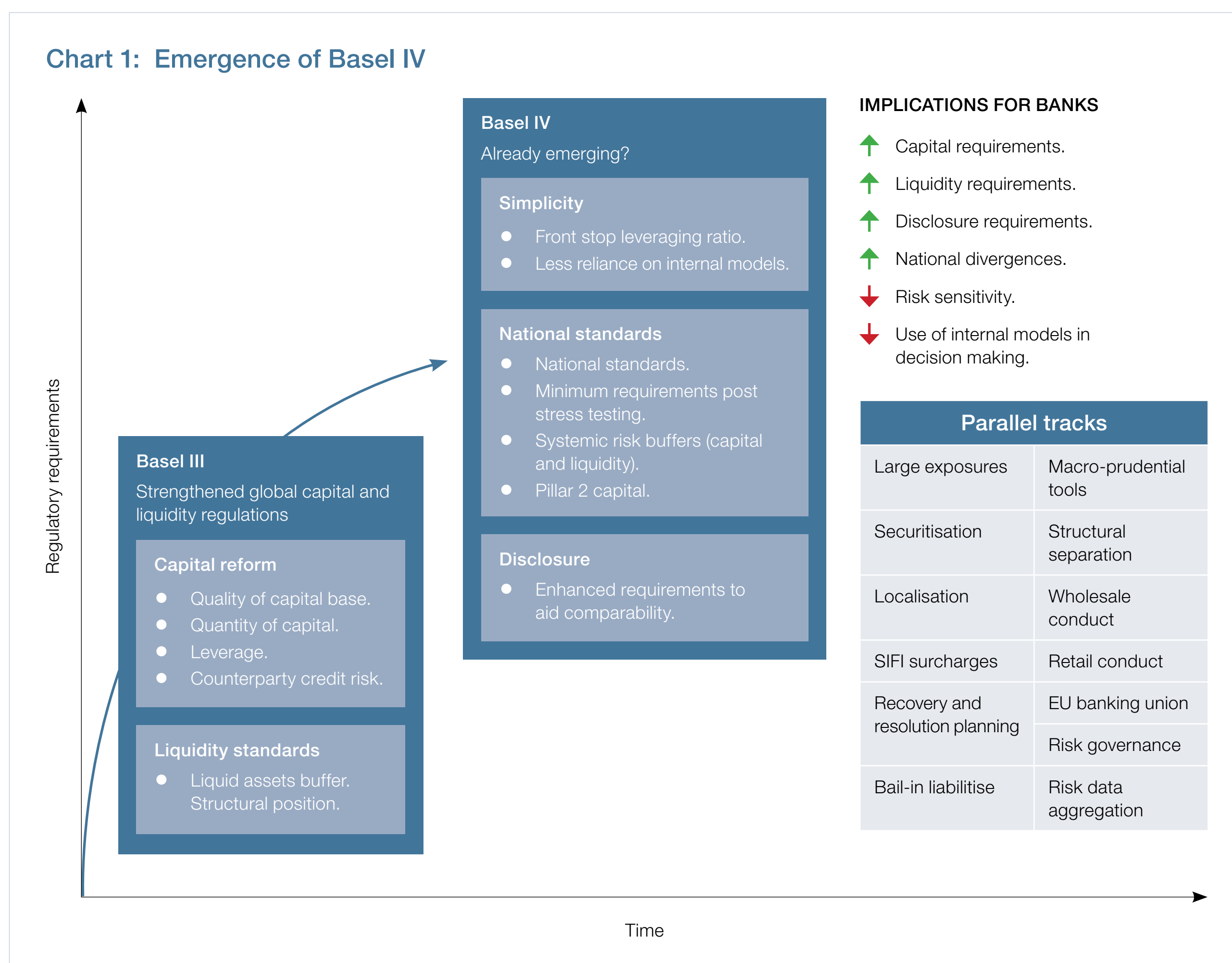
The retreat of bank finance means that those in the SME sector, lacking the capital markets recourse of their corporate peers, are finding credit increasingly difficult to access. "Europe has certainly gone through a period of very weak economic activity and weaker, higher costing bank lending," says Clive Briault, Senior Advisor, EMA Financial Services at KPMG. "At a time when macro prudential analysis is telling us that we probably need to release some capital, banks are being encouraged to hold more." Causation is difficult to disentangle, Briault adds, but one could argue that "all that it is doing is having a very pro-cyclical effect, by reinforcing the downward part of the cycle."

Perhaps one small blessing for corporates is the relief Europe granted last year to trade finance from the required one-year maturity rule for risk-weighted assets and a move back to the 20% credit conversion factor for secured letters of credit (LC). Had the regulation remained as originally drafted, all exposures – including low-risk, short-term and self-liquidating trade instruments such as LCs – would have been treated as equally risky. That would have almost certainly pushed up the cost of trade finance, with some estimates suggesting an increase of as much as 75 basis points.

Growing importance of SCF

While traditional forms of credit are likely to retrench in the wake of Basel III, certain forms of credit such as the provision of receivables-based and supply chain finance (SCF) are likely to receive a significant boost. The reasons are twofold. Firstly, the constraints that bank regulation continues to exert upon bank lending to SMEs, will almost certainly encourage more of these businesses to consider alternative methods of funding the business. Meanwhile, corporate buyers are increasingly cognisant of the pressure the credit shortage is putting on their supply chains, and are looking for ways to bolster the balance sheets of their suppliers, while improving their own working capital. SCF, which has been growing at a rate of 25-30% since the crisis, would seem like the ideal solution for both parties.

The second point is that SCF will become a more attractive activity for banks following the full implementation of the Basel Committee's recommendations. This is because relative to other types of facility, SCF is deemed to be fairly low risk and will therefore remain low cost, Anil Walia, Head of Supply Chain Finance at RBS, explains. "While LCs are likely to become more expensive, receivables purchasing through SCF programmes will become cheaper for the banks," says Walia. "Since they will be able to provide that at a reduced cost that is where the funds will start flowing in the years."



Source: KPMG Evolving Banking Regulation 2014

Changing relationships

Other banking regulations implemented in the past year are impacting companies in a more direct way. Trade reporting regulations – such as the European Market Infrastructure Regulation (EMIR) – are one example. Under EMIR, corporates that use OTC derivatives products will be required to report trades to one of the newly appointed trade repositories.

For corporates who have never been directly subject to financial regulation before, achieving compliance ahead of the deadline has required them to climb a very steep learning curve. In order to do that, a large number have had to draw upon the expertise of their banking partners. "Treasurers are now finding themselves subject to a whole set of regulations that are often quite complex and lengthy," says Lloyds' Burge. "They are very conscious of how big the range of different requirements they need to understand is, and that has required a lot of education."

On that point, there is a large degree of consensus. "Everyone is suffering from the range and complexity of these requirements," says Ruth Wandhöfer, Global Head of Regulatory and Market Strategy at Citi Transaction Services. On the positive side, the regulatory burden is at least fostering closer relationships between corporates and their banking partners – something which is increasingly vital for businesses attempting to navigate the changing regulatory landscape. "Sometimes it becomes a community of shared suffering, which is of course good for client relationships in the sense that you always have something to talk about," she jokes. Citi, she adds, is therefore working hard to make sense of the ever-expanding plethora of regulatory changes and communicating what needs to be done to corporate clients.

The threat of Balkanisation

One of the chief concerns of local financial regulators since the crisis has been to prevent the need to rescue large cross-border banks from collapse in future financial crises. This is driving structural change within the banking sector. An increasing number of national regulators – notably Germany and the UK – are bringing in requirements stipulating that banks operate within their jurisdictions not as branches, but as subsidiaries, each with enough capital to stand alone. For a large international bank, that, in essence, means an end to many of the advantages that can be derived from the pooling of capital and liquidity, such as being able to use surpluses in one country to fund deficits in another.

A shift from a largely global system of entities into a patchwork of smaller, locally funded and regulated subsidiaries will likely be a source of alarm to treasurers of multinational companies. It is certainly one of the trends that worries Wandhöfer the most. "That has the potential to – greatly influence global banking in the long run. I think it could have a huge impact on the network. While suggesting that this type of regulatory response would make delivering these services all but impossible for banks would be an overstatement, it is not difficult to see how it might affect the cost."

A bank's ability to move liquidity inter-company on behalf of a client is enormously dependent upon being able to move the funds between branches seamlessly. If the system becomes too fragmented, the result might be that transactions will require the use of external clearing systems. That will mean costs will rise and transactions will need to be submitted earlier, Wandhöfer explains. "Ultimately it could mean that everything becomes more expensive and less efficient for the corporate." KPMG's Briault agrees. "Increasing localisation or 'Balkanisation' is likely to make it more expensive for international banking groups across the world to operate and that will inevitably push up the price of their services to end users, such as global corporates, too."

It's not over yet

Given all the disruption and uncertainty that has resulted, treasurers will surely be eager for the process of regulatory upheaval within the banking sector to culminate soon. However, there are still a lot of issues under discussion – not least where Basel III is concerned.

"I think we are about halfway through," Briault says. A KPMG report published last September, which Briault co-authored, describes it in more striking terms. Even though the original 2019 deadline for the final phase of Basel III implementation is still some way off, some regimes may yet shift towards a 'Basel IV' standard characterised by tougher requirements on the leverage ratio, risk-weighted assets and stress testing. Differences are already emerging. The US and European authorities, for instance, are requiring banks to meet minimum capital ratios after a severe stress test, while others are moving minimum leverage ratios above the prescribed 3%. There is not going to be much respite then. In fact, it could be the case that by the time banks are finally able to fully meet the new regulatory requirements, they will already be out of date.

Corporates, when not managing compliance projects of their own, will need to continue monitoring developments and trying to understand the implications. That might involve, amongst other things, budgeting for increased bank fees and performing regular assessments of the impact upon interest income and expenses.

Developing an awareness of the potential macroeconomic consequences might also give treasurers an edge in the practise of risk management. A growing fear amongst banks is that the relentless regulatory onslaught may already be taking economies – Europe in particular – past the "tipping point" to where the costs far exceed the benefits. If the range of services banks provide to their corporate clients continue to rise in cost, KPMG believes a potentially permanent downward drag on economic growth could manifest, exceeding any benefits gained from improved stability. It would be sensible for treasurers, therefore, to anticipate – or at least not rule out – future periods of financial instability and adjust their strategies accordingly.

As regulatory pressures on banks continue to grow, corporates will continue to look at funding alternatives such as the capital markets, says Briault. Banks will always be needed for payments and basic cash management services, he explains, but greater fragmentation might necessitate treasury to take more of "a pick and mix approach" rather than relying on one banking group for all their funding and liquidity needs.

Finally, if global banking continues to gradually fragment, corporates that traditionally partner with one or several banks internationally might need to change their approach. "Treasurers may find that some banks are pulling out of certain locations as the costs of services go up due to localisation pressures," says Briault. "That is a change they should be preparing themselves for now." ■

Pooling: crossing the border

Cross-border cash pooling solutions can help corporates to optimise their cash management structures by pooling their funds into a single liquidity basket. However, they can also prove to be an administrative headache. We explain what cross-border pooling options are widely available to treasurers and how they work.

A cross-border or multi-country cash pool is a cash management structure that allows a business to concentrate the cash it holds in different countries, across separate bank accounts, in one location. This technique provides corporates with an effective way of interest optimisation and improved liquidity management as excess balances from one subsidiary can be used to offset debit balances in another. A cross-border cash pool can be a physical, notional or hybrid structure, depending on the jurisdictions covered and the legal requirements therein.

For the purposes of this article, we are using a definition of pooling that includes both sweeping and notional pooling. This may differ slightly from the definitions used by some cash management banks who prefer to classify sweeping structures, including zero balance account and target balancing structures as cash concentration rather than pooling. When establishing a cross-border cash pooling structure, the first choice that the treasurer has to make is whether to opt for pooling per legal entity or pooling per country.

Pooling per legal entity

When a subsidiary maintains multiple bank accounts in different currencies and countries, pooling the bank balances in each country on a legal entity basis can offer benefits to the group treasury. Cross-border sweeps are delivered to a pool in one country – concentrating all the subsidiary's cash into a single position and providing much sought after visibility over all accounts. From this position, the net balance is swept to a master account in a central cash pool on either a notional or zero balance basis.

Pooling per country

If the decision is made to set up pooling per country, cash pools set up in the participating countries will see the various subsidiaries' bank account balances swept to a master account in each country. These master account balances are then swept cross-border into a central pool in the main country of operation.

Multi-bank cross-border solutions

Cross-border pooling solutions can also be categorised according to whether multiple local banks are used in each country, or a single network that covers the region (or indeed the world) is employed. Using local banks in each individual country may be advantageous if the corporate operates in a relatively small number of countries, especially if it requires highly specific local expertise and services.

Using a larger regional network bank offers the advantages of harmonised services and documentation, and the possibility to execute true end-of-day-based cross-border zero balancing. In order for a regional network bank to be a viable option, it must have branches or operating subsidiaries operating in all the countries in which the corporate is active.

It is sometimes possible to implement a hybrid solution, whereby domestic banks provide local services, such as payments and collections, whereas a larger regional bank provides cash pooling services. With these hybrid solutions, balances held with local banks are often concentrated to a central treasury account held with the pooling bank.

Certain banks even offer multi-bank sweeping services that automatically transfer balances between local bank accounts and the main cash management bank. Using SWIFT messages, the cash management bank monitors the sub-account balances at the local banks, before sending a transfer request to transfer the funds to the master account. The receiving local bank then executes a payment instruction that transfers the money to the cash management bank.

Since cross-border multi-bank sweeps go through the correspondent banking process, the sweeps usually happen before the end of the business day, and it is often impossible to achieve a zero balance using this setup. However, it can be possible to achieve a zero balance through multi-bank sweeping in cases where banks develop collaborative solutions.

Cross-border zero balancing

When the corporate has established the main country of operation they wish to use for cross-border zero balancing structure, they then need to set up bank accounts with the concentration bank in this country. The focus for all liquidity in the structure is on a single master account in this country. Depending on factors such as the scope of operations and the type of business that the corporate operates in, the corporate will have to weigh up the benefits of potential locations, as well as carrying out a thorough evaluation of the tax and legal issues that may exist in the potential locations.

There are a variety of ways in which a cross-border zero balancing sweeping arrangement can be set up:

1. Cross-border zero balancing by legal entity

Automatic sweeps from the subsidiaries' bank accounts in the different country branches of the concentration bank go directly to the master account at the central pooling location. Should the subsidiary have multiple bank accounts in the same country, the balances need to be consolidated or netted on to one account before this process, to limit the cross-border sweeps to one per country. If a corporate uses cross-border zero balancing by legal entity, they need to be aware of the tax issues that can arise from cross-border inter-company loans being created between the master account holder and the operating companies.

2. Cross-border zero balancing with domestic zero balancing

If the corporate has a number of subsidiaries in each participating country, a two-step process can reduce the number of cross-border transfers involved in the sweeping arrangement. In this case, the master account holder would open a non-resident bank account, or target account, with the concentration bank in each participating country. The purpose of this is to enable cash concentration to take place on a domestic basis within each country first, prior to a second cross-border zero balancing sweep arrangement from the target account in each country to the master account held in the final pooling location. Once again, cross-border inter-company loans are generated by cross-border zero balancing with domestic zero balancing.

3. Cross-border zero balancing with domestic notional pooling

In this set up, the subsidiary balances are notionally pooled in each country first. The cross-border transfer is made from a master account in each of the domestic notional pools to the master account in the central pool location, taking the balance of each country's notional pool to zero.

Not every bank offers notional pooling, so the corporate will need to ensure this is possible with their preferred bank before proceeding. In most cases, the group treasury is the master account holder in the zero balance pool in each country, as well as at the central pool location. This solution allows local subsidiaries to maintain ownership of their cash balances and negates the need for inter-company loans.

The one exception to this rule is if any inter-company loans arise between the master account holders of the domestic cash pools and the central master account holder. The only way that this could happen is if the master account holder in the zero balance pool in each country is different from the master account holder in the central pool location.

Variation on a theme

Banks often adapt their cross-border zero balancing solutions to meet the particular needs of the company. Beyond a plain vanilla ZBA, there are also several variations on the end-of-day sweeping theme:

- **Constant balancing** operates on exactly the same principle as zero balancing, but a residual amount is maintained in the sub-accounts as opposed to a balance

of zero. The advantage to sub-account holders of this method is that a balance is immediately available at the start of the trading day to action payments, and interest is accrued on the sub-accounts.

- **Target balancing** differs from plain vanilla ZBAs in that transfers are made from the master account to the sub-accounts in the opposite direction to which the zero balancing transfers were sent, so the sub-accounts keep a target balance. As the target transfers have a book date of 'today' but a value date of 'tomorrow', the sub-accounts always have a credit book balance but a zero value balance.
- **Trigger balancing** is when upper and lower amounts are set on sub-accounts. Balances that exceed these amounts trigger the zero balancing process to take place, but only on those sub-accounts that meet the limits (these limits may vary for each sub-account). Trigger balancing can eliminate the need to sweep insignificant balances and lower the number of sweeps that take place, which in turn can reduce banking costs.

Some banks also offer the possibility to execute zero-balance sweeps at intervals other than the standard end-of-day frequency. This may benefit companies when activity on certain sub-accounts is low during certain periods of the month or year.

Cross-border notional pooling

A cross-border notional pool allows corporates to optimise interest across a number of accounts in a variety of countries. In this case, the debit and credit balances of the participating accounts in each separate country are pooled for interest purposes. This may or may not involve cross-border transfers.

Structuring notional cash pools on a cross-border basis can be difficult, due to the cross-guarantees required. This is one of the reasons why some banks that offer domestic notional pooling may not also offer cross-border notional pooling. Once again, cross-border tax and legal issues must also be taken into account by the corporate if they are to achieve full set-off. Some of the variations that corporates should be aware of from banks that offer this structure include:

- Some banks may only arrange cross-border notional pools in major currencies.
- Some banks will only arrange cross-border interest compensation.
- Some banks may insist that the funds must first be physically transferred to one account in each pooling location before the accounts are notionally pooled cross-border.

It is possible that the bank may offer a cross-border notional cash pool without any transfers of the liquidity balances being required. With no transfers, there is no single location for this type of cash pool. The bank simply calculates the interest differently or arranges rebates to reflect the credit and debit balances that are being maintained.

Once it is established that a cross-border notional cash pool is the corporate's preferred option, and their chosen bank can provide this in the countries required, an assessment of the structure being offered is required by the treasury to establish whether it meets business requirements of the organisation.

Some of the main structures for cross-border notional pooling are outlined as follows:

1. Cross-border notional pooling with domestic zero balancing by country

In this structure, a domestic zero balancing cash pool is set up in each participating country. The balances on the master accounts for each of the domestic zero balancing country pools are then swept cross-border to accounts in the same name in the central notional pool. Sweeps can be two-way or one-way, depending on the treasury's requirements. The country accounts in the central pool are notionally pooled for interest purposes. Using this structure, inter-company loans can be created in country, but not cross-border.

If the master account holders in the domestic pools are local subsidiaries, this type of structure can be very useful. Ultimate control of the notional pool master account will most likely lie with group treasury.

2. Cross-border notional pooling with cross-border zero balancing by legal entity

Unlike the first option above, this structure negates the need for a domestic cash pool to be established, as cross-border sweeps are made on a legal entity basis. Within the cross-border notional pool, separate accounts are opened for each subsidiary using the structure. Sweeps are set up from all accounts held by the subsidiary in every country directly to its notional pool account in the ultimate pooling location. In some circumstances, the subsidiary may have multiple bank accounts in any one country. In this case, it can be beneficial to zero balance on a legal entity basis within the country first.

Cross-border notional pooling with cross-border zero balancing by legal entity ensures that there is no co-mingling of funds between subsidiary balances. The subsidiaries themselves retain control of their operating accounts, while their balances are simultaneously used to improve the group's interest charge. Should the subsidiaries require funding at the local level, the two-way zero balancing sweeps also enable them to be funded indirectly by the master account holder in the cross-border notional pool.

3. Cross-border notional pooling with domestic notional pooling

In-country notional cash pools are established for each country that the corporate requires in this structure. The master account holder for each of these then arranges transfers to an account in their own name that resides in the cross-border notional pool in the main pooling location. These accounts are then notionally pooled. The main benefit of this structure is found on the legal side, as the amount of participating accounts in the cross-border notional pool is streamlined.

Restrictions

The wide variety of liquidity management structures that exist offer the treasurer the opportunity to gain full visibility over their end-to-end cash flows and positions. More than that, they also then allow the treasurer to make their corporate cash work harder for the business. It is also important for the treasurer to be fully aware of the legal and tax requirements of the structure they choose to implement, and they should pay particular attention to any regional or national legislative restrictions. ■

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RISK MANAGEMENT

FX hedging

Currency risk exists in one form or another for most companies, not least those with overseas operations. Hedging can reduce or remove that risk, but when and how should treasurers approach it? This article answers these questions and more.

CASH MANAGEMENT

Overlay cash pooling

As companies' footprints become more international and multi-bank relationships become the norm, cash pooling that allows global visibility is no mean feat. Overlay arrangements may hold the answer – but how exactly do they work, and how are they evolving to meet the needs of today's treasurer?

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

Amit Agarwal, EMEA Head of Liquidity Management Services, Citi; **Clive Briault**, Senior Advisor, EMA Financial Services, KPMG; **Nick Burge**, Managing Director and Head of OTC Clearing, Lloyds Bank; **John Byma**, Director of Global Treasury, Procter & Gamble; **Eugenio Cavenaghi**, Director of Trade and Working Capital, Barclays; **John Chiodi**, Chief Investment Officer, Liquidity, Americas, HSBC; **Juan Pablo Cuevas**, Head of Global Transaction Services for Latin America and the Caribbean, Bank of America Merrill Lynch; **Olivier Gayno**, Chief Investment Officer Wealth and EMEA Liquidity, France, HSBC; **Sean Gilfeather**, Head of Corporate Pensions, Actuarial, Lorica Employee Benefits; **Barry Harbison**, Senior Product Specialist, Liquidity, Americas, HSBC; **Bert Heirbaut**, Treasury Manager, InterContinental Hotels Group plc; **Emre Karter**, Central and Eastern Europe Cluster Head, Treasury and Trade Solutions, Citi; **Friedemann Kirchhof**, Head of Supply Chain Finance, Siemens; **Angela Koll**, Product Manager International Business, Commerzbank; **Paul Lahiff**, Chairman, New Payments Platform Steering Committee; **Paul Lee**, Head of Investment Affairs, National Association of Pension Funds (UK); **Raj Mody**, Head of Pensions, PwC; **Annemarie Moore**, Group Treasuer, Plan International; **Robert O'Donoghue**, Managing Director and Global Head of Working Capital Management, ING; **Marco Oviedo**, Chief Economist for Mexico, Barclays; **Avinash Persaud**, Emeritus Professor, Gresham College; **Stephen Peters**, a Vice-President, Clear2Pay; **Yuri Polyakov**, Head of Financial Risk Advisory, Lloyds Banking Group; **Bruce Proctor**, Head of Global Trade and Supply Chain Finance, Bank of America Merrill Lynch; **Jennifer Ramsey-Armorer**, Director of Treasury, BlackBerry; **Dimitrios Raptis**, EMEA Head of Market Management, Liquidity Management Services, Citi; **Simon Shingleton**, Regional Head of Multinationals Sales – Global Payments and Cash Management, Latin America, HSBC; **Anil Walia**, Head of Supply Chain Finance, RBS; **Ruth Wandhöfer**, Global Head of Regulatory and Market Strategy, Citi Transaction Services.

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