



## Emerging market FX

Recent volatility has presented treasurers with additional challenges when managing emerging market FX. With hedging sometimes difficult to achieve, or overly expensive, what is the best way to minimise the potential impact of such currency fluctuations?



### The Corporate View

**Kofi Erskine Aduku**

Senior Vice President, Group Treasury  
**Mubadala Development Company**



### Mobilising liquidity

If liquidity is not sufficiently or efficiently mobilised, this can have numerous negative effects on a corporate's financial well-being. The good news is that there are several ways treasurers can look to remedy the situation.

### Investing

The new MMF landscape

### Career Prospects

Being an interim treasurer

### Back to Basics

How to ace an RFP

### Bigger Picture

The Rothschild dynasty

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# We will all pay for over-regulation

You only have to talk to a banker these days and the increasing cost of regulation is the first or second topic of conversation. In fact, it is sometimes the first and the second topic of conversation.

You only have to peruse any of the banks' recent results and the increasing cost of compliance is not only reported, but also the subject of specific comment. The banks cannot do much about this and one could say they brought it on themselves. But the level of regulation is now becoming overwhelming as each government introduces its own version of the rules. Banks operating in multiple jurisdictions find themselves facing different versions of the same kind of regulation, each with its own local variation.

You only have to go to an industry conference and the issues being discussed are the same. At the recent ICC Banking Commission Annual Meeting in Singapore, the discussion kicked off with commentary on how banks were exiting some areas of trade finance because of the increasing compliance and risk costs. New Basel ratios are requiring more capital for the banks' trade business. Doing business with low risk-weighted multinationals is becoming more attractive than doing business with other more highly risk-rated companies.

You only have to start looking at the increased capital requirements being imposed on the banking groups and then wonder where the return on this increased capital is going to come from. Global systemically important banks, also referred to as 'too big to fail', face even higher capital requirements under the recently clarified TLAC (Total Loss Absorbency Capacity) requirements.

So far, so good. Safer banks taking less risk. But, there is another unfortunate side effect that is beginning to emerge. The regulation is encouraging banks to shrink their balance sheets to meet capital requirements. This may mean exiting or selling existing business streams or passing (selling) portfolios of risk to others, namely, other investors who do not have the same capital constraints, such as investment funds of various sorts. Sound familiar?

Yes it does, and the funds are not stupid. They are hesitant and seeking only the best portfolios of risk. So this encourages the banks to adopt business models that create, package and distribute large volumes of the best quality assets – loans and other facilities to the strongest corporate credits. Everyone else will start to have fewer financing options.

Meanwhile, new liquidity rules are making short-term deposits from customers much less attractive. Have you been offered 30 day deposits yet? One year deposits will be sought as we move towards 2018. So much for corporate liquidity requirements with money market funds also facing challenging regulation.

Even the most basic functions such as opening a bank account are being affected, as our recent webinar with the Singapore ACTS showed. Just establishing a new banking relationship is fraught with evolving requirements, as KYC (Know Your Customer) is becoming KYCC (Know Your Customer's Customer) and AML (Anti Money Laundering) is becoming ML/TF (anti Money Laundering and Terrorist Financing). This is leading banks to exit their relationships with other banks, let alone their corporate customers.

Banks may be safer, but they are being over regulated and their ability to meet customers' basic banking and financing requirements is being seriously hampered. We will all end up paying for this increased regulation.



## A volatile mix: EM currencies

Various multinationals have bemoaned the bottom line impact of currency volatility since the start of this year and while currency risk comes with the territory of doing business in emerging markets, the heightened volatility at this time is creating additional challenges. But what can treasurers do to minimise FX risk, especially in the emerging markets?



## Nathan Rothschild: the mastermind behind the dynasty

Rothschild is arguably one of the most famous family names in the world of finance. In this article, Treasury Today shines a spotlight on Nathan Rothschild, the man who led the family to be recognised as one of the most powerful European banking dynasties.

## Moving in waves



Inefficient mobilisation of liquidity has a number of negative effects on corporate financial well-being and in an economic environment beset by market volatility and low returns, global treasury operations are faced with a daunting task. We explore the different ways that treasurers can more effectively mobilise their liquidity.

The rapid evolution of payment systems and solutions, together with the growing digitisation of corporate banking services, look set to fundamentally change the way that corporate treasurers operate. How do these innovations fit into a corporate's operating model, and where can they help to solve specific treasury challenges?

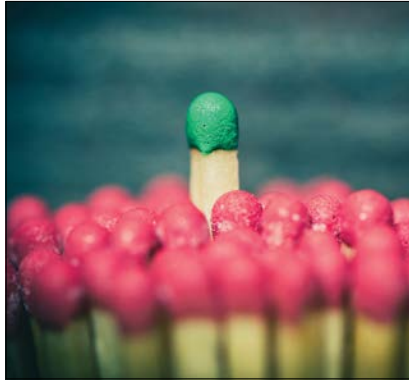
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**The point of no returns**

Since 2012, the European Money Market Fund (MMF) industry has been shrinking. For many, the negative interest rate environment and the new regulatory proposals set out by the European Commission were set to speed up the industry's decline. Is this the case, or have some spoken a bit too soon? Treasury Today investigates.



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**A day in the life: interim treasury**

Change and uncertainty are two of the main appeals – and challenges – of being an interim treasurer. It may be tough to find a role and quickly adapt to meet the requirements of the assignment, but the rewards both financially, and in terms of job satisfaction, can make it all worthwhile.



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**18 The Corporate View**

**Kofi Erskine Aduku**  
Senior Vice President, Group Treasury



In the world of treasury there is a constant demand to deliver the best outcomes and no room for complacency. For Kofi Erskine Aduku, this can only be achieved with an ongoing focus on improvement and an ability – and willingness – to develop new and creative approaches. In this article Kofi shares how he has implemented this philosophy into the Mubadala treasury and how he came to manage the financial risks for one of the Middle East's largest investment and development companies.

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**How to ace an RFP**

In the world of corporate treasury, there are few 'one-size-fits-all' solutions. So when looking for new services and banking partners or updating current systems, a choice will need to be made concerning what solution is selected and from whom. The Request for Proposal (RFP) is a core tool in the process and we explore how to develop a best-in-class RFP.



**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](http://treasurytoday.com) as they are ready. The Treasury Insights weekly email summarises the new pieces from that week plus other news relevant to treasury. You can register for this free service at [treasurytoday.com](http://treasurytoday.com)**

## SCF gaining new converts

Supply chain finance (SCF) continues to gain momentum globally. The World Supply Chain Finance Report 2015, from BCR Publishing estimated that the discipline could now be worth as much as €43bn in terms of funds in use and is growing at a rate of around 30% per year.

Some interesting insights around the issue of supplier onboarding emerged from one of the panel discussions at the recent Receivables Finance International (RFX) 2015 convention in Madrid. Corporates have in the past sometimes been guilty of underestimating the complexity of the onboarding challenge and the time needed to get it right, Peter Davidsson, Treasury Director EMEA, at Whirlpool told the 170-odd delegates in attendance. In his own experience, it was only as the company began to roll out a segmented implementation strategy for its SCF programme that he and his team began to fully appreciate the difficulty of the task at hand.

Yet as he went on to explain, treasury found this strategy to be absolutely essential for achieving the highest level of acceptance amongst the supplier base and, by extension of that, making the implementation of a SCF programme a worthwhile endeavour. "We learnt that to diversify pricing in relation to cost of funds is important," Davidsson explained. "You want your suppliers to accept this. You want your suppliers to see this as a great opportunity. But you are always going to have different levels of acceptance between a big industrial commodity provider with a very low funding cost and a small family company, for example."

### Lessons learnt

What was quite evident from the accounts given by all the panellists at RFX 2015 was that as buyers become more experienced in rolling out SCF solutions, thorny issues like supplier onboarding are becoming less and less of a difficulty. Most corporate buyers are now aware of what complications they are likely to encounter in advance of implementation (something which as Davidsson's remarks revealed was not always the case) and, with the help of similarly experienced banking partners, have effective plans of action they can implement should any issues arise. Add to this the fact that, thanks to e-invoicing, SCF is becoming more than the preserve of the largest suppliers and one would not bet against it becoming ever more mainstream moving forward.

## Spreadsheet setbacks: you're not alone

The fact that spreadsheets can be prone to producing dangerous financial errors is no great secret. Yet the recent study by modelling experts F1F9, which attempted to quantify the associated risk still makes for quite startling reading. The report, which harvested data from international market research company YouGov, claims that errors in spreadsheets could be putting billions of pounds at risk.

But perhaps the problem is less about spreadsheets themselves, and more around how they are used. Enrico Camerinelli, a Senior Analyst at Aite Group certainly thinks this is the case. The F1F9 report places the blame at the door of companies that are not investing sufficiently in training (not a surprising conclusion, given that modelling training is one of the services F1F9 offers). Apparently, in one third of the businesses surveyed none of the financial decision makers had ever received any "official external training". But as Camerinelli points out, it can also be the other extreme too. Sometimes an error is caused not by a lack of proficiency in using spreadsheets but, somewhat counterintuitively, an over-proficiency. "It is those spreadsheets with multiple tables, and links and references to other files. That is what I think makes spreadsheets really dangerous."

If experts can make mistakes that are just as dangerous as complete novices when it comes to using spreadsheets then it would follow that training, while certainly helpful, can by no means prevent every error. That might help to explain both why a large number of companies in the F1F9 survey, even despite the increased regulatory focus on data accuracy, have not made much investment in modelling training. It might also help to explain why ClusterSeven, a provider of spreadsheet checking software, now boasts one third of the world's top 30 banks as clients.

So, while a cost-effective, flexible application that can replace the spreadsheet might still be some way off, the technology capable of addressing the spreadsheet's propensity to produce errors is evidently not. ■

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# ME cash management

“ With so much focus on electronic payments in the region, what do readers consider to be the key developments in the Middle East cash management space today? ”



**Murali Subramanian**  
Executive Vice President  
Abu Dhabi Commercial Bank

In the Middle Eastern cash management space, handling of physical cash is still critical though non-cash payment products have been in use for many decades. Credit and debit cards for instance have increased in use in the region over the past 25 years, in keeping with the consumption orientation of the larger economies in the region. The infrastructure to support non-cash payments outside the wealthiest economies (UAE, and other GCC countries) is still developing. Retail sales continue to attract large volumes of cash though tax avoidance has never been an issue – this relates more to the cost of non-cash transactions that is slowly coming down as governments seek to improve the ratio of non-cash usage.

The value of cash transactions is reducing because large corporate-to-corporate payments are now electronic or cheque-based, but SMEs still need to be further integrated into the alternative payments space.

Central Bank initiatives within the region, including GCC RTGS (Real Time Gross Settlement), direct debits, and FCY clearing, together with other payment initiatives such as M-Wallet and intelligent Cash Deposit Machines are advancing the region's infrastructure capabilities. Today, what the West perceives as 'conventional financial infrastructure' – credit and debit transfers, high and low value transfers, ACH, RTGS – is largely in place in all ME countries. There has also been focus on adding further clearing capabilities in the region; in addition to local currencies, there is talk of potentially introducing dollar and euro clearing capabilities domestically as approximately a third of all dollar and euro payments originating from the ME actually goes back to the region.

For corporate treasurers in the ME, payment and clearing is just one dimension of their role. There has been a progressive upscaling of their remit over the past few years with more responsibilities coming their way. Managing liquidity, risk and forecasting market operations – amongst other accountabilities – means automation is a priority in the bank selection process. In the ME region, however, the level of shared infrastructure capabilities found in a more developed economy are not consistently available. Yes, there are banks that do everything in an automated way, but equally there are many that insist on receiving paper instructions or may receive an electronic instruction but convert it back to paper.

Adding to the complexity of bank relationships in the region is the fact that treasurers need to hedge their liquidity, but there isn't a

well-developed domestic debt capital market in the region. So, the only way a treasurer can fund their enterprise needs is through bilateral funding from banks (unless the company chooses to list on an exchange overseas – but that would be a decision for only the biggest of entities and would involve other considerations such as having to obtain a credit rating).

As such, maintaining good banking relationships continues to be a priority for the treasurer. By definition, this means having to deal with several banks, but equally there is a clear focus on wallet share. Of key consideration is placing and integrating their operating business with as few banks as possible (because banking in the region is still, by and large, quasi-manual – the true level of automation and shared infrastructure is not quite here yet) but also having borrowing capabilities with as many as possible. For larger companies, a desire to be agnostic is somewhat commonplace; behaviour that tends to be in defence of reducing the number of banks a corporate wishes to use for payments and collections. In this instance, the qualifier for bank selection will be whether it is SWIFT enabled.

Looking forward, the preoccupation of tactical management of bank relationships and cost management will be joined by increasing focus on management of liquidity, management of market risks from FX, ensuring continuity of business and selecting architecture of enterprise platforms to automate workflows.



**Alawi H. Al-Shurafa**  
Treasurer  
Saudi Chevron Phillips  
& Affiliates\*

Of particular current and relevant concern to the cash management landscape in the Middle East (ME) are several key factors including: liquidity, compliance, automation and de-risking. Naturally, liquidity will always be important in this part of the world as many companies are centered on the spectrum of oil but, with the current pricing environment of crude, corporates are justified in being nervous. There is a requirement, at the very least, to ensure the company has enough cash to fulfil its commitments. To this end, I have seen a number of corporates renewing their revolving credit facilities and looking at the possibilities of expanding existing revolvers.

With regard to compliance, the lack of standardised Know Your Customer (KYC) processes and the difficulties in keeping up with changes can be a headache for corporates in the region. The different circumstances in the ME are not always reflected. For example, for global banks, something as simple as certifying the physical address of a board member of a company in certain places in the ME where people use PO boxes can have



implications for fulfilling compliance requirements. Local banks have an enhanced understanding of the ME environment but, for global companies, cross-border presence is crucial.

The tighter controls and compliance is, the harder it is for corporates in terms of ease of doing business. There is a move from KYC to Know Your Customer's Customer (KYCC) – banks do not always engage in trade finance transactions because of international sanctions and associated risk; requirements for such transactions, therefore, can put pressure on corporates' working capital.

Moreover, the global banks are increasingly careful in their business dealings and aren't as keen to explore areas with potential risk. The banks' approach to calculated risk and the occurrence of de-risking is an area of concern for treasurers. Consequently, what the region is seeing is a bank-corporate relationship that needs to be in line with an expanded scope of compliance, coupled with cautious risk-weighting. Despite the aforementioned, treasurers must look at banking relationships holistically, optimising the presence of key banking partners who are well suited to support the corporates' operational needs.

Finally, the amount of attention automation is receiving in ME is interesting these days after lagging behind areas, such as Europe, for a long period of time. I like to call it 'SWIFTism': after relying for so long on banks' propriety platforms and host-to-host connectivity, there is a trend of corporates looking at SWIFT – in particular, SWIFT Alliance Lite2 – to do their cash management activities. Corporate treasury departments in the region are already technology-focused but as many corporates implement or consider implementing SWIFT, the region is becoming increasingly globally connected.

*\*These are the personal views of the spokesperson, not the views of Saudi Chevron Phillips & Affiliates*



**Pradeep Prakash**  
Senior Treasury Manager  
Majid Al Futtaim Holding LLC

Cash management in the Middle East (ME) continues to be an evolving landscape. In just five to six years, it has developed into what is now a very interesting time for innovative ways to manage cash. Having said that, most corporate treasuries prefer to follow a tried and tested model. The main developments in the ME cash management space revolve around four key areas – visibility, pooling, payments and collections. Whilst visibility of cash is not the concern it once used to be, the emerging ways to manage this issue today are focused on innovative MT940 reporting and bank statement aggregation by lead banks. In addition, having a dynamic group treasury sign-off on any new banking relationship helps capture new bank accounts, which in the past would be

'invisible'. Majid Al Futtaim has a quarterly process in place that reconciles the internal bank position to bank confirmations. A number of banks offer this statement aggregation service (albeit at a balance reporting level and not transaction level), and various e-platforms and vendors offer both balance and transaction reporting.

With an increasing sense of urgency, innovative solutions to achieve pooling are being sought out by corporates since this acts as a source of internal funding to optimise debt positions. However, good forecasting still remains a challenge to managing optimal cash positions. Other key hurdles to pooling in ME are withholding taxes in geographies such as Egypt, so hybrid pooling is crucial. Selecting a banking partner who can offer the best solution is important and requirements need to be clearly defined at the start of the partnership. Innovative pooling solutions (offered mainly by international banks) are freeing up a lot of captive cash in various markets.

Traditionally, from a pure finance background, payables processing staff have been either unaware of, or unable to see the importance of improving payment methods. Majid Al Futtaim works on current industry-standard payment methods, via middleware and SWIFT. This has helped to demonstrate a very good value proposition across our businesses – through cost/benefit analysis and negotiating a reduction in bank transaction costs, along with the obvious benefits of reduced operational risk and achieving greater STP rates.

Increasingly, a large number of corporates are starting to look at the payments and cash management landscape as an area of innovation which could truly result in a bank agnostic model. This would give treasurers much more operational freedom in consolidating balances, by providing better visibility, and greater yield optimisation potential on corporate cash. With a bank agnostic model, we see existing house-banks trying to retain relationships and 'lock-in' new clients through traditional host-to-host propositions. However, it is interesting to see that some leading international banks are also still trying to inject a level of bank-required customisation in file design. This would, to a very minor extent, dilute a true 100% bank agnostic proposition.

In the collections space, the direct debit mandate by United Arab Emirates Central Bank is the newest initiative, which currently applies to the financial institution (FI) space. Corporates have shown a cautious interest, and not many banks offer such a service. We see a lot of banks trying to position direct debits as a value proposition, if only to ensure new business. The feedback we get from our underlying businesses is on the security of cheques that have been tendered against receivables, and whether direct debits would offer the same level of legal protection that the cheques do today.

In conclusion, we continue to be excited by the change in the traditional view of payments, and see this to be an increasingly dynamic space for innovation and greater value propositions among both banks and corporates. ■

## The next question:

"How is treasury benchmarking evolving? With increasing use of technology, are there any new measures which should be used to benchmark the performance of treasury departments?"

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

# End of monetary easing approaches

*Despite many starting the year being sceptical about how effective quantitative easing would be in the Eurozone, more recently, optimism is growing. In this article, ECR explores where Eurozone QE might head next and looks at the possible timeline for a rate hike in the US.*

The European Central Bank (ECB) is flooding the system with liquidity. The result: negative interest rates on safe sovereign bonds in the Eurozone, euro weakness, rising share prices, and narrowing credit spreads. By contrast, central banks in the UK and the US have a tightening bias. However, the effect has been limited as interest rates in both countries are comparatively high, so their stock and bond markets attract a lot of capital from the rest of the world, where monetary policy is still loose. For this reason, both the dollar and the pound are expensive.

Market conditions are almost ideal for investors. There is upward pressure on prices everywhere – particularly on share and property prices. But how much longer will this situation last and when will the period of ultra-loose monetary policy end? In a sense, the answer seems simple. Namely, as soon as an upward economic spiral starts up and the deflation risks have disappeared or as soon as it becomes clear that the drawbacks of the current monetary policy outweigh the advantages.

An equally relevant question is: what will happen when the money taps are turned off? Many prices are bound to tumble but as long as the economy as a whole continues to grow, such price drops need not continue for too long. Nevertheless, long-term interest rates will rise substantially in such a climate.

## Growth prospects in Europe increasingly positive

Many economists were sceptical about the effectiveness of quantitative easing (QE) in the Eurozone. However, a few months after the ECB started QE, we are seeing more optimism. To start with, bond yields have dropped further than expected. This is because two important European institutions are pursuing totally opposite policies in terms of credit supply. On the one hand, the financial regulators are forcing the banks to shrink their balance sheets and build up capital buffers. Both requirements imply that the banks can only supply limited credit. In addition, to comply with current regulation banks, insurers and pension funds need or want to have a substantial portion of their assets invested in safe government bonds (even if these are loss-making, due to negative interest rates).

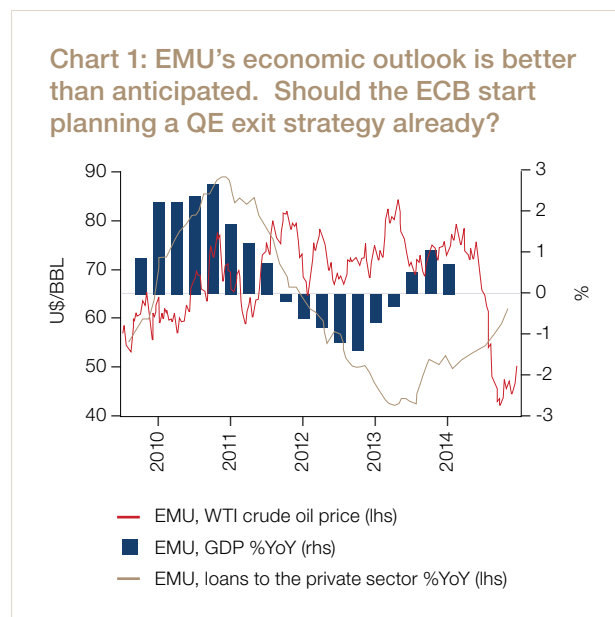
On the other hand, the ECB is pulling out all the stops to get credit to ease, as this would be good for growth and ward off deflation. Therefore, the central bank has been pumping huge amounts of money into the financial system to ensure

that the banks can lend more – to such an extent that deposit rates have turned negative.

Recent data shows that, by now, minimal interest rates and money creation by the ECB are having a positive effect on lending. On top of this, euro weakness and rising property prices are boosting Eurozone growth (on the back of low interest rates, many investors are buying real estate in anticipation of a handsome profit). In combination with lower oil prices, this explains why the European growth data has recently exceeded expectations. In other words, it appears that the ECB is helping an economy that has already started to improve. This has prompted numerous commentators to recommend an early end to QE. Presently, the ECB maintains that it will stay the course until September 2016, as planned. However, if the data continues to develop positively, this may well be too much of a good thing.

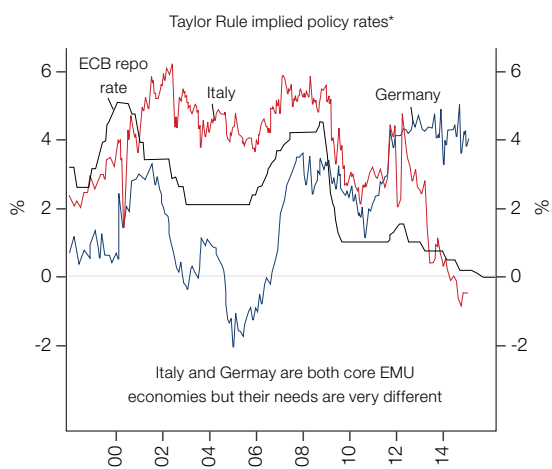
## European-specific trends

Germany already has full employment and wages are increasing. The current rates of interest are far too low for Germany, whereas the euro is too cheap, which causes



Source: Thomson Reuters Datastream/ECR

## Chart 2: Taylor rule analysis suggests that Germany needs tighter money while Italian economy needs monetary loosening



\*Based on Fathom Consulting research

Source: Thomson Reuters Datastream/ECR

growth to accelerate even more. If Germany is to prevent inflation, as well as various other imbalances, it will need a tighter monetary policy in the not too distant future, especially since it will not be possible to offset the disproportionate monetary easing (for Germany) through tight fiscal policy and/or so-called macro prudential measures.

The question is: what will weigh heavier as far as the central bank is concerned? The need to stimulate the weak economies through ultra-loose monetary policy, or the fact that the Eurozone's strongest economy will weaken unless monetary tightening takes place? It has been said that it would be 'good news' for the rest of Europe if the German economy overheats, as this would boost Germany's export sector. In the short term, this could be true but eventually, imbalances will occur that are bound to undermine the robust German economy. In addition, there is little doubt that rising inflation in Germany will strengthen the anti-Europe movement. If we combine this with the possibility of a Grexit, which could be very costly for Germany – losses of up to €100-€150bn would be conceivable – it is clear that Eurozone tensions could run high.

Considering the pros and cons, our conclusion is that the ECB will probably continue with its current policy but it could

yield to German pressure (eg decide to unwind QE earlier) in the autumn. At the same time, we cannot rule out that Eurozone tensions will flare up before that time. Firstly, due to the question whether it is wise to keep Greece in the European Monetary Union (EMU) and subsequently, due to disagreements about adapting the monetary policy to Germany's needs.

## Higher US lending rate a matter of time

The prospects for the US economy are bright. As a result of robust job growth and rising wages, aggregate income has increased and so have asset values, while inflation is low, which is boosting purchasing power. The most likely prognosis seems to be that US economic growth will pick up in the near future. If growth improves, it will only be a matter of time before jobless rates drop so much that wage increases start to rise – leading to an upward economic spiral in the US. We predict an initial Fed rate hike would soon follow.

Currently, the markets are discounting very slow and limited rate hikes in the United States. In all likelihood, the thinking is that as indebtedness is still high (while asset prices could show a knee-jerk reaction to monetary tightening), higher interest rates will soon affect credit supply and economic growth. ECR sees this differently: we expect a rate hike once wage increases are on the rise, which will make the economy better able to cope with rising interest rates. Furthermore, it will attract more capital flows to the US, which will compensate for the adverse effect of the Fed rate hikes.

Based on the above, we do not think the Fed will be in any real hurry to increase interest rates. In any event, we would expect the Fed to move very slowly at the start of the tightening process. Therefore, initially we do not foresee substantial damage to the financial markets (although a sea change from accommodative to restrictive is too significant to leave the markets cold). Subsequently, conditions in the stock and bond markets could worsen rapidly on rising inflation expectations due to accelerating growth, higher wages, and (overly) loose monetary policy. Higher inflation expectations will put upward pressure on bond yields and fuel speculation on faster Fed rate hikes.

Although, for the coming months, we expect fairly strong downward pressure on long-term interest rates, higher economic growth, rising inflation expectations and tighter Fed policy will result in rising long-term rates later this year. We expect the ten-year EUR swap rate to rise to 1.25% while the ten-year USD swap rate could rise to 2.9% at the end of 2015. ■

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# A volatile mix: EM currencies

*While currency risk comes with the territory of doing business in emerging markets, heightened volatility at this time is creating additional challenges. We ask several industry experts: what can treasurers do about it?*

Various multinationals have bemoaned the bottom line impact of currency volatility since the start of this year. Diageo, for example, blamed it for a fall in revenues from Latin America and the Caribbean, while Volvo sought to minimise the impact of FX volatility by announcing plans to build a plant in the US.

On the other hand, Unilever's first quarter results were boosted by favourable currency movements and Danone also came out ahead. But the experiences of Unilever and Danone are untypical according to the latest FIREapps currency impact report, which found that North American and European corporates reported a combined negative currency impact of almost \$40bn last year.

Corporates on the other side of the Atlantic were most affected – North American companies reported \$27.1bn in total negative currency impact for 2014, a 53% increase since 2013. And the impact wasn't limited to a few big names either; in the final quarter of last year, 46% of North American

and 51% of European companies had to report material currency-related impacts.

But what can treasurers do to minimise FX risk, especially in the emerging markets?

## Tackling volatility

Andrew Gage, Global Head of Research at FIREapps, recommends that the approach to managing emerging market (EM) currency volatility should be the same as for developed markets. "Inter-company loans, hedging, option and natural hedges are all potential methods of countering risk – for companies with and without operations in emerging markets." Therefore, he concludes, "the best strategy you can employ is having complete data." He accepts that borrowing in local currency and managing working capital effectively can help reduce the impact of currency fluctuation,

but also refers to the importance of having a full understanding of exposures and flows.

Meanwhile, Sander van Tol, Partner at treasury consultancy Zanders has a slightly different view: it has always been important for corporate treasury to manage their exposures on EM FX, but higher volatility and increased exposure has made it even more important, he observes. Compared to developed countries, he sees some material differences in the management of these specific risks, which can be categorised as: the regulatory environment; a lack of liquidity; limited hedging products and higher hedging costs.

“The regulatory environment is a key driver in EMs. The majority of EM currencies are restricted and not freely convertible, but because some are linked or pegged to another currency or basket of currencies, a proxy hedge could be a solution.” For instance, five out of the six currencies in the Gulf Cooperation Council (GCC) are pegged to the dollar, so a dollar hedge means a hedge in these five GCC currencies. Another example is the Chinese yuan, which is pegged to a basket of international currencies. The downside of such a proxy hedge is the uncertainty that a country can choose to unpeg its currency, which makes the hedge highly ineffective.

## Local borrowing

Rando Bruns, Group Treasurer at Merck, observes that high interest rates in many EM countries make hedging expensive and economically uninteresting. Corporates will have to live with that risk and apply a long-term view, he adds. “Local borrowing can be an instrument to reduce exposure, although the high interest rates need to be weighed against this exposure.”

Borrowing in local currencies is one of the traditional techniques used for FX exposure management. To the extent that timing differences between revenues and expenses can be managed, FX exposures can be managed at a lower cost and at a lower volatility to the financial statements explains Patrick Trozzo, Vice President for Reval. “However, many companies are also employing technology and more advanced strategies by automating the process of gathering FX exposures across multiple entities and efficiently netting them to optimise the execution of FX derivatives and reduce transaction fees.”

According to Ronald Leven, FX pre-trade Strategist at Thomson Reuters, the impact of currency fluctuations is largely a by-product of mismatched exposure profile for assets and liabilities. “Hence, local borrowing (when possible) can be a very effective tool for buffering a firm from currency fluctuations.”

## Avoiding volatility

Another technique for reducing the impact of EM currency movements, says Lauren Goodwin, an Associate Practice Leader Global Analytics at Frontier Strategy Group, is for corporates to consider country-specific factors since these can provide meaningful information as to where currency volatility may be most rampant. She suggests the questions corporates could ask include the following:

- Where are central banks most likely to be controlled by political factors (rather than economic logic), thus, leaving them more susceptible to volatility?

- Which countries have meaningful FX reserves that can be used to protect the currency in the event of a global macroeconomic shock?
- Would multilateral or local banks be willing to lend to the government (buy bonds) in the event of trouble?
- Is liquidity a serious risk?

In terms of what treasurers can do to manage EM volatility, she says clients should consider ‘operational’ hedging, which can buffer the treasury against large currency movements. “At the higher-risk end of the spectrum, corporates could complete a strategic acquisition to lessen the impact of currency on sourcing and production.”

## Moving money

The ability to move money out of certain countries is usually investigated carefully before a corporate invests in a country in the first place, explains Brian Welch, Director UserCare Treasury Consultancy. “Sometimes companies will invest in a particular country because of its economic potential, but if there are potential problems about paying dividends out of those countries the initial investment may be made with loans rather than equity, as the loans are sometimes more easily repaid. Similarly, finance from within those countries might be possible and preferable, so that any balance sheet exposure can be offset by local loans in the same currency.”

In the latter case, a counterparty risk will arise with a domestic bank or other financial institution. Although the local investment legislation might require the corporate to use a local bank – in which case the corporate will aim to use the best rated bank in that country. “There is less risk borrowing from a local bank than investing local cash with the same bank,” says Welch. “There is also the possibility of one of the global banks providing some kind of service.” Many EM countries maintain exchange control regulations to prevent the unlimited transfer of funds out of the country – but the existence of those regulations usually also means that there is an official route by which funds can be transferred out.

In general, the more volatile and free a currency is, the more flexibility corporates have to move money out of the country, says Bruns. “The best example of this is Venezuela, which has a highly regulated FX rate and restrictions on moving money out of the country. Counterparty risk goes along with this.” He also refers to the impact of political stability on a corporate’s ability to move cash as well as on FX rates.

The typical treasury team, according to Gage, often has a blindspot into its EM finances due to a pattern of opaqueness created by how businesses in emerging markets are acquired/integrated. “Legacy systems and processes often create areas that the team cannot see into, create a lag in the system or are not consistent with company-wide processes. These nuances often make it hard, if not impossible to manage the risk associated with these markets.”

The extent to which the typical corporate treasury team has sufficient resources to effectively manage emerging market currency exposure depends on the size of the organisation, says Bruns. “Having said that, I believe it is good to be rather close to those currencies.” Improvements in the process of moving money in and out of EMs, according to Trozzo, have somewhat cushioned the impact of emerging market currency volatility on corporates. He goes on to explain that there are

fewer cases of rigid currency conversion restrictions, which had been driven previously by frequent periods of hyper-inflation.

## Additional considerations

Factors such as banking infrastructure and political stability are taken into account when assessing risk in an EM, although Trozzo observes that such issues are of less concern than they were in the 1990s. Globalisation and investment in technology have upgraded banking infrastructures worldwide and many EM countries have established local financial markets that connect to global financial markets.

David Blair, an independent Treasury Consultant based in Singapore, observes that currency volatility is not limited to EMs, though the EM volatility has been exaggerated by dollar strengthening. According to Blair, EM currency volatility has yet to directly impact on exchange controls, while borrowing in local currency and managing working capital effectively can help reduce the impact of fluctuation. "Hedging is possible in most Asian EMs, both onshore and offshore via non-deliverable forwards and many treasurers are actively hedging. The typical multinational company will also have local currency receivable and hard currency payable for sales and the reverse for production.

"Funding local sales operations in local currency reduces risk, as does producing and selling in-country. Long day sales outstanding (DSO) in local currency add to risk; efficient working capital management, therefore, is vital." Blair also warns that many corporate treasury teams lack the manpower to effectively manage EM currency exposure. "Most treasuries are under-resourced and multinationals that have centralised globally for cost reasons are left with no or limited EM expertise."

According to Leven, recent earnings releases would suggest that the strong dollar has been a much bigger issue for corporates than volatility, causing potential credit problems for a lot of EM companies that are dollar-funded. Since most corporate exposure to EMs has a long time horizon, political stability is probably the number one issue, he continues. Banking infrastructure may also be a factor in determining whether to hedge on- or off-shore.

## Risk appetite

Market makers' reduced appetite for risk, general uncertainty in the commodities market, increased regulation and continued uncertainty over Greece's future as a member of the Eurozone have all contributed to volatility, explains Jon Dovener, Head of Emerging Markets, Lloyds Bank Commercial Banking. His colleague, James Buckle, Director of Industrials, says treasurers will usually try and use a well-established bank with a local presence and understanding, which can give them a real-time assessment of the local risks. "Alternatively, they may be inclined to use the local market's leading bank. Any treasurer will value a local presence in a region deemed to have certain socio economic and political risks."

Resources could be a factor – but approach and governance are more important according to Peter Wong, Associate Director, PwC Corporate Treasury Consulting in Hong Kong/China and Founding Chairman of the International Association of CFOs and Corporate Treasurers (IACCT) China. "A recent PwC corporate treasury survey found FX risk was the number one risk exposure, yet only 8% of treasurers adopted an

active or dynamic approach that took into account business strategies and activities (including physical supply chain) with the goal of maximising market opportunities and profitability and cash flow."

While accepting that borrowing in local currency and managing working capital effectively can reduce the impact of currency fluctuation, Buckle adds that certain larger corporates have a preference to fund centrally for a number of reasons (including cost), so may elect to utilise synthetic funding options such as a cross currency swap as opposed to borrowing locally.

"We see several differences in EM FX hedging strategies," says van Tol. "The first is that exposure is managed from a portfolio perspective in which the imperfect correlations between the different currencies lower the exposure and hence hedging costs. Furthermore, corporates apply a shorter hedging duration in order to decrease costs of carry. Thirdly, more option structures are used to protect the corporate against specific event risks of a very material depreciation of the currency. The final difference is that macro-economic outlooks are used to determine a risk map or consensus on currencies to be used as guidance on hedge ratios.

"In order to reduce transaction risk, corporates can either change to invoicing in hard currencies or use FX adjustment clauses in their sales contracts. Whether this is possible depends very much on the market and sector you are operating in." Van Tol believes that treasurers need to change their approach, strategy and hedging instruments: investing in specialised exposure quantification and dynamic hedging strategies pays off but normally, as he explains, that is only perceived as such after the occurrence of an event risk – the depreciation of the Russian ruble or the peso crisis, for instance.

Goodwin observes that any increase in global risk or major tightening by central banks (particularly by the US Federal Reserve, likely in Q4 2015) will lead to a reduction in EM flows and amplified currency volatility. "Currency volatility itself doesn't make counterparty or credit risk more likely, but the causes of currency volatility do. The impending US interest rate hike is increasing volatility and makes countries with high proportions of corporate and sovereign dollar-denominated debt (much of Latin America, Angola, Kazakhstan) vulnerable to currency volatility while increasing the likelihood of capital controls."

## External pressures

Welch acknowledges that the decision to expand operations into a new EM will come from the sales or manufacturing parts of a company and such momentum is often difficult to stop with treasury concerns about banking infrastructure or political stability. Companies with EM operations are likely to be supported by a reasonably sized treasury team, but EMs are often challenging, he concludes.

"External advice from the local offices of the major accounting firms is usually essential, together with advice from the global or local banks. There will also be a need for local financial staff and expertise, although they may not be officially part of treasury.

"The local banking facilities may be quite different from European banking, possibly with a higher usage of cash and cheques and less secure methods of collection and delivery. Practical local treasury management issues are possibly more time consuming than EM currency exposure management," he concludes. ■



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# Nathan Rothschild: the mastermind behind the dynasty

*Born in Frankfurt in 1777, Nathan Rothschild led his family to be recognised as one of the most famous European banking dynasties. Having amassed such a vast fortune and embraced an inclination for secrecy, speculation still cloaks the true character of the Rothschild bloodline.*

It started with an emblem. In 1743, a goldsmith named Moses Amschel Bauer opened a counting house in Frankfurt. Over the door, Bauer placed a sign depicting a Roman eagle on a red shield and the company became known as the 'red shield' firm – in German, 'rotes-schild'. When his son, Mayer Amschel Bauer, inherited the business, he changed his name to Rothschild; the renowned bloodline title – and the legends surrounding it – began.

## Initial lessons

Mayer Amschel Rothschild fathered five sons (and, perhaps less well known, five daughters). This article centres on Mayer's third son – Nathan Rothschild. Having arrived in England in the early 1800s, Nathan, undaunted by initial language barriers, spent his first years on English soil as a cloth merchant based in Manchester.

Although separated from his family since the move, they were always linked in business. Indeed, shared commercial ideas for the cloth trade had always been part of the Rothschild plan. Nathan's father's strong business connections across Europe helped gain knowledge that a war with Napoleon was imminent. Aware that the majority of fabric for British Army and Navy uniforms came from Germany, Nathan was dispatched to buy up ample stock. When manufacturers were given contracts by the British Government, they inevitably found stock was in short supply and, thus, were obliged to buy from the Rothschilds. Manchester manufacturers were in uproar over Nathan's underhand tactics, and his subsequent departure for London in 1805 is probably best described as 'fleeing'.

Nathan's time in the north of England proved insightful for the family; cloth dealings revealed that efficient communication was key to outperforming competitors. After Nathan's move to London, the Rothschilds avidly sought out 'inside' information across the continent and employed the fastest couriers in order to stay ahead of competitors. Such advantage was achievable since, when merchants faced trade disruptions from the Napoleonic wars – where dependence on traditional access to overseas markets was no longer profitable – Nathan figured out ways around the blockades imposed across Europe. Not only

## Vital statistics

Full name: Nathan Mayer Freiherr von Rothschild

Born: 16<sup>th</sup> September 1777

Died: 28<sup>th</sup> July 1836

did Nathan diversify into trading indigo, pearls, tortoise shell and ivory, he, along with other merchants of the day, also engaged in smuggling. At a time when communication systems and trade routes were practically non-existent or painstakingly slow, the family's private courier system – which consisted of a network of men, sailboats and, later, carrier pigeons – was especially innovative.

## Pioneering international finance

In 1808, Nathan seized the opportunity of escalating market prices of gold and silver and was the first of his brothers to branch out into the financial services business. The firm, based in London, is today known as N M Rothschild & Sons.

To understand how the Rothschilds made their fortune it is beneficial to know something of the financial environment during the 19<sup>th</sup> Century. During this time, a majority of European countries ran sizeable budget deficits – that is, their fiscal policies were usually insufficient to meet expenditures. Borrowing proved expensive as most countries were considered unreliable creditors and charged high interest rates. As a consequence these deficits were difficult to finance and so very often were funded by either the sale of royal assets or through inflation.

The British state was an exception to this rule. Since the latter part of the 17<sup>th</sup> century, the country had developed a system of public borrowing (the national debt) and monetary management (the Bank of England) that was quite sophisticated for the age. Mayer Amschel Bauer had taught his sons that lending to government officials would produce



far greater profits than lending to individuals as they were always secured from public taxes.

With brothers in major European cities (Frankfurt, Naples, Vienna, France, and London), the Rothschilds established an international financial service. The system enabled British investors, and other rich capitalists in Western Europe, to invest in the deficits of countries by purchasing internationally tradable, fixed-interest transferable bonds. It invented – or at any rate popularised – the government bond. Allowing investors to buy chunks of the states' debts was attractive because, as prices fluctuated in relation to the performance of the issuing government, shrewd investors could make colossal profits. For the governments, bonds were beneficial as they enabled enormous sums of money to be raised. The Rothschilds, of course, got a cut of everything and became somewhat indispensable to the solvency of certain states.

## Financing wars

From their five European bases, the Rothschilds were able to finance significant parts of the Napoleonic war. A risk, taken by Nathan in 1811, of sending money to the Duke of Wellington in Spain gained the trust of John Charles Herries, the British official responsible for financing Wellington's efforts. Although sending large shipments of gold into war-torn regions was risky, Nathan was able to ship the gold because of his prior knowledge of smuggling routes and the family's unsurpassed communication links. The respect earned from Herries resulted in other government accounts being directed towards the Rothschilds.

Between 1813 and 1815, Nathan almost single-handedly financed the British war efforts; and over a 12 month period he provided the British government with nearly £10m (approximately £6.5bn today). Meanwhile, however, his four brothers financed the French war effort – N M Rothschild & Sons were receiving interest from both sides of the Napoleonic war. Napoleon's defeat in June 1815 did not result in the culmination of international financial services provided by Nathan and his brothers – in fact, quite the reverse. Indemnities and debts created by the war needed to be settled. Fiscal cutbacks and monetary stabilisation in Britain required new investment and, for those who became accustomed to high-yielding bonds during war years, it remained an attractive prospect.

## Rothschild fortune

For the best part of 100 years, between 1815 and 1914, N M Rothschild & Sons was the biggest bank in the world. The Rothschilds were in a league of their own and the 20<sup>th</sup> century offers no comparison – no international banking group today shares the supremacy that N M Rothschild & Sons once enjoyed, nor does any individual today own as large a share of the world's wealth as Nathan and his brother James once did (in the mid-1820s until the 1860s). Secrecy, however, was paramount to the Rothschild family so the exact figures remain elusive.

Such wealth enabled the dynasty to famously 'bail out' the Bank of England (BoE) in 1826, preventing the collapse of the entire banking system. The previous year had seen hordes of English firms investing in newly-independent Latin American countries. When the countries defaulted on their loans some 3,000 firms went under and, as the BoE had supplied those companies with their finances, Nathan rescued the bank before bankruptcy caused it to close its doors.

## The legend of the puppeteer

Despite being involved with such high profile 'rescues', all of the Rothschilds have, for one reason or another, been the subject of suspicion. The main accusation that surrounds the Rothschild dynasty centres on Nathan's alleged early knowledge of British victory at the Battle of Waterloo. At a time when markets, uncertain whether Napoleon would succeed (undermining the value of government bonds in Britain) or be defeated (thus, sending the value of British bonds soaring), legend suggests that Nathan engineered a situation that enabled his company to make an impressive fortune.

The theory is that his private courier system alerted Nathan of Napoleon's defeat before official news reached London, supposedly facilitating his circulation of false rumours. By tricking the London stock market into believing Napoleon had won, Nathan could depress the market – only for his employees to buy up stock before news of the real outcome emerged.

The story only surfaced years after the battle, however. The earliest account on record, published by Georges Dairnavael, claimed that Rothschild gained a 24 hour head start on official news, allowing him to net an estimated £135m. Although Dairnavael's allegations are marred by his demand to Nathan's brother, James, for money in return for not publishing the story, further articles followed. So, is there any truth to the claims?

Family records admit that Nathan did, because of their efficient communication system, have access to early knowledge of the victory. The Rothschild version, however, maintains that Nathan tried to inform Lord Castlereagh, the British Foreign Secretary, before making the most out of the opportunity on the stock market without trickery.

Although it would have been possible to gain a significant head start on official news by riding directly from Waterloo at the moment of victory, modern historians believe the claims that Nathan made millions lack credibility. It is more likely that the family business made its huge profits from governmental finance and bond speculation over a much longer period. In fact, their investments had bet on a prolonged military effort and victory would have caused some disruption to the business.

## Nathan's significance

While Nathan Rothschild did make money by financing arms, his breakthrough had been years prior to the hostilities – operating with sophistication in high-risk bond price speculations and commissions during a time when few others dared to. During hostilities, he dealt with the contradiction of his business (countries mainly borrowed money to wage war which was actually detrimental to a stable bond market) and avoided lending to belligerent nations.

"It takes a great deal of boldness, mixed with a vast deal of caution, to acquire a great fortune; but then it takes ten times as much wit to keep it after you have got it as it took to make it," said Nathan's father. Dying before bearing witness to the Rothschild dynasty's true success, the founding father couldn't have predicted his son's strengths better. Leaving aside the fanciful tales and narratives interspersed with speculation, then, Nathan Rothschild introduced concepts of rapid communication, high volumes and diversification into the financial world on his ascent to power. He understood, before most, that time and information meant money. ■

# Innovation and digitisation: the treasurer's imperative

*Far from being mere industry buzzwords, the rapid evolution of payment systems and solutions, together with the growing digitisation of corporate banking services, look set to fundamentally change the way that corporate treasurers operate. From virtual accounts to in-depth analytics, the digital world is your oyster.*

When we think about innovation, it's tempting to skip straight to the 'exciting' part. But in addition to understanding the new technologies and channels that are re-shaping the cash management landscape, it is important to grasp how such innovation fits into a corporate's operating model, and where it can help to solve specific treasury challenges.

Looking first at the macro picture, it's clear that corporates operating internationally have to contend with numerous external forces that are impacting the supply and/or delivery of goods, as well as the money flows associated with them. Geopolitical developments are one such force, with tensions in Eastern Europe and the Middle East making corporates all the more aware of country and counterparty risk. Indeed, certain geographies are becoming increasingly difficult or undesirable to move funds into or out of, and certain banks are retrenching from non-core countries, leaving some treasurers with significant hurdles to overcome.

"Another factor, which is in many ways correlated to this geopolitical unrest, is currency volatility," says Mark Buitenhek, Global Head, ING Transaction Services. "The recent strengthening of the dollar, for example, has made it difficult to predict the FX impact on the payments streams of corporates," he notes. Together with the economic uncertainty surrounding quantitative easing measures and the impact of negative interest rates, these bigger picture concerns are now heavily influencing the day-to-day business of a corporate, and specifically the treasury function.

Financial regulation adds another layer of complexity here. "Even though the vast majority of regulation is being imposed directly on the world's banks, not corporates, there is inevitably a knock-on effect. Take Basel III, for example: the liquidity coverage ratio and the leverage ratio will impact the availability and cost of certain products of banks going forward, with notional pooling being of particular note," adds Buitenhek.

As Dick Oskam, Global Head of Sales, ING Transaction Services, explains: "Put simply, under Basel III, banks must calculate their liquidity ratios based on the gross value of individual accounts, rather than netting the outstanding balances of accounts in the notional pool. In order to cover any negative positions in a notional pool, banks must therefore hold more liquidity – which will ultimately make certain notional pooling constructions more expensive for treasurers." Oskam believes it is too early to say whether the demand for notional pooling will drop off sharply, or whether the product will remain a cost-effective tool for both treasurers and banks. "One thing that is certain, however, is that forward-thinking corporates are already starting to explore alternatives to notional pools," he observes.

## An alternative approach

The logical upshot of these discussions, he says, is to examine the potential of on-behalf-of structures (OBO), namely payments- (POBO) and collections-on-behalf-of (COBO). Although these structures require "a completely different way of operating," they also offer treasurers the ability to significantly reduce the number of bank accounts they operate, and reduce general administrative expenses. "It's about getting treasurers to re-evaluate the tools they have become accustomed to. For instance, while a notional pool might offer benefits from an interest point of view, the level of administration to maintain the pool, be it on the side of the corporate or on the side of the bank, is usually quite significant. By implementing a POBO/COBO structure and streamlining the account set-up, it is possible to massively reduce the administration burden, whilst also finding an alternative to notional pooling," says Oskam.

Another interesting development that is helping treasurers to find alternatives to previously clunky or complex cash management structures is the rise of virtual accounts. These can help rationalise the number of physical accounts held by a corporate, whilst allowing the company to gain superior visibility over its cash and liquidity, and minimising accounts receivable (AR) and reconciliation issues – without adding layers of complexity or expensive technology.

"Although virtual accounts are yet to become globally available, there are certain countries, such as Poland, where they are being used with great success," Oskam adds. "Of course, in an ideal world, treasurers would be able to operate virtual accounts across the globe, or at least across the European region, but for that to happen we need harmonised legislation, which will take time. It is also due to having various clearing houses and schemes across Europe." Nevertheless, Oskam believes that virtual accounts offer treasurers significant efficiency potential – and that the benefits will only increase as the solution becomes more pervasive.

## Re-writing the rules

Just as virtual accounts and OBO structures are pushing the boundaries of international cash management, the global focus on instant payments could also dramatically change the way that corporates operate. “Imagine a situation where real-time payments can be made on a 24/7 basis. That would totally transform the way that corporates work – and it’s something the banks are very focused on right now. Not only are we seeing talks taking place in the US, Australia, and across Asia, but there is also a concerted effort around instant payments in Europe, orchestrated by the ECB, local central banks, and banks like ING,” says Oskam.

“Forty or 50 years ago, it took us weeks to get money from A to B. Over the years, the time delay became days, and then within a day. Ensuring that all payments are instant could therefore be the final step that can ever be taken in this area, and we are keen to drive progress towards that real-time goal.” This, Buitenhek explains, is part of ING’s strategy to become a truly digital bank. “Today, there are 23,000 start-ups working in FinTech – the majority of which are looking for ways to improve the customer experience and service, whilst creating efficiencies at the back end. Some of them are looking to work with banks; others are looking to provide an alternative to traditional banking models.

“And whilst competition in the sector should be encouraged, we believe collaboration is the way forward. That’s why we are working with a select group of smaller players across the globe and why we have set up an innovation centre to work towards digitising our complete offering. In fact, we are currently preparing the launch of our new electronic gateway for customers,” he notes. This will be a multi-channel offering, with desktop, tablet and mobile access.

## Get with the programme

ING’s – and indeed the wider industry’s – digitisation push is not just about new products though; digitisation is also bringing traditional treasury tools up-to-speed, giving treasurers the benefits innovation, but in a tried and tested environment. “Take corporate cards, for example,” notes Buitenhek. “Today, with the advent of virtual cards, they are being used by corporates not only as a procurement tool but also as a tool for working capital management – since they significantly increase visibility and control, whilst improving payment cycle times and reducing manual touch points. And at a time when the treasurer is increasingly responsible for the whole buying process within the company, this can only be a welcome development.”

Taking this a step further, ING has recently announced a partnership with Basware to support companies with further optimising their P2P process and their working capital management. This partnership will see ING offer an automated invoice payment solution that can be easily added to the existing P2P workflow. “Extending the benefits of electronic invoicing to include payment is an integral part of our strategy of taking advantage of innovation in order to serve the evolving needs of our customers,” Buitenhek explains.

These are just two concrete examples of how digital financial services and e-payments innovation can improve financial processes (including helping to reduce fraud), increase visibility and improve cash flow. But for the treasurer, the true benefits of being able to optimise liquidity positions, in real-time, come alive through the analytical tools that digitisation is fostering. “As well as providing a complete range of e-services, ING is incorporating advanced analytics into our new digital portal. These analytics will not only help the bank to service its customers in the best way possible, but also provide customers with an added layer of information that is only possible through digitisation – including reporting functionality.”

The analytics also give the bank the ability to flag potential opportunities for efficiency within the customer’s business. “For example, the analytics might suggest that, based on your dollar rating or on a supplier’s rating, now would be a good time to set-up a supplier finance programme,” Buitenhek explains.

“In short, it’s about gaining a fuller appreciation of the big picture, whilst identifying specific opportunities to improve, speed up and streamline a company’s working capital management,” he concludes. And where digitisation and innovation allow the treasurer to better react to the company’s current cash and working capital needs, analytics allow the treasurer to better predict what is coming down the line – so that they can take appropriate measures in advance. Forewarned is forearmed.



### Mark Buitenhek

Global Head, Transaction Services

Mark Buitenhek has been Global Head of ING Transaction Services since 1<sup>st</sup> January 2014. Buitenhek has more than 25 years of experience in banking and particularly in the payments, cash management and cards industry. Over the years, he has led many payments initiatives as well as strategic projects and change programmes in both the Retail and Commercial Divisions of ING.



### Dick Oskam

Global Head of Sales, Transaction Services

Dick Oskam, Global Head of Sales for Transaction Services joined ING in February 2015. Oskam is responsible for developing and bolstering the Transaction Services offering across ING’s Commercial Bank. He has over 21 years of banking experience and has built a longstanding, international career within commercial banking. His most recent role was Head of GTS Netherlands for RBS. Prior to his role at RBS, he spent 17 years at ABN AMRO where he held various senior roles in Latin America, Asia, Europe and the Middle East.



## In pole position

### Kofi Erskine Aduku

Senior Vice President, Group Treasury



If there is one character trait common to those who set benchmarks of excellence in any profession it is the willingness to continually look for new and better ways of doing things. Kofi Erskine Aduku has just that kind of outlook. In this article, he tells us how he came to be managing the financial risks for one of the Middle East's largest investment and development companies and why in treasury, just like in the motorsport which he devotedly follows, one can never be complacent in the pursuit of efficiency.

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*Established and owned by the Government of Abu Dhabi, Mubadala's strategy is built on the creation of partnerships and on long-term, capital-intensive investments that deliver strong financial returns, contribute to the growth and diversification of Abu Dhabi's economy, and create opportunities for current and future generations in the United Arab Emirates.*

*Mubadala brings together and manages a multi-billion dollar portfolio of local, regional and international investments and partners with leading global organisations to operate businesses across a wide range of industry sectors. These include aerospace, semiconductors, metals and mining, oil and gas, renewables, information and communications technology, healthcare, real estate and infrastructure, utilities, and defence services.*

One evening in Abu Dhabi last November, while the fastest racing drivers in the world were hurling their vehicles around the corners of the beautifully futuristic Yas Marina Circuit, one UAE-based treasury professional, watching nearby, was considering the qualities needed to succeed both at the top of his profession and race competitively in a Grand Prix.

While Lewis Hamilton claimed all the glory that day by winning the race and securing his second world championship title, those who know the sport will tell you this was far more than just one man's achievement. "If you follow the sport closely you see that it is 100% about teamwork," says Kofi Erskine Aduku, Senior Vice President, Group Treasury at Mubadala Development Company, an investment and development company owned by the Government of Abu Dhabi, and headquartered a short 20 minute drive from the Yas Marina circuit. Group Treasury forms part of the Corporate Finance & Treasury Unit that oversees Mubadala's Treasury, Structured Finance & Capital Markets and Mergers & Acquisitions practices, optimising capital structures for Mubadala and Mubadala Group and supporting mergers and acquisitions across the group. The treasury team is responsible for the management of financial risks such as liquidity, interest rate, foreign exchange, equity, commodity and counterparty risks.

"We all work hand-in-hand. We have a very collaborative approach to delivering the best outcome for the organisation."

Winning in Formula One, he explains, largely comes down to the ability of teams to pull together individual talents for the advancement of the team. Then there is that relentless pursuit of efficiency. Take the lightning-fast ballet that is the F1 pit stop. For every stop, there will be one mechanic whose sole job it is to pull away a particular tyre, another to make slight wing adjustments, and someone else to hold the lollipop, and so on. "Each crew member will keep practicing and practicing their particular routine so that when the time comes they know exactly what to do," Kofi explains. "They never get complacent about the job in hand and they are always trying to find new efficiencies that will make the car go that fraction of a second quicker."

It is an example of seamless collaboration that Kofi believes is equally applicable in the world of treasury. When it comes to implementing a particular risk management strategy, Kofi and his team operate in a similar fashion: each individual has their own technical task to perform which when pooled together in the right way delivers the best result for the organisation. Together at the corporate level of the organisation, Kofi and his team will strive to identify and analyse all the risks they are exposed to across the asset classes, before making recommendations for mitigative actions to the Financial Risk Group (a body of the finance family that is chaired by the Group CFO) and then to the Investment Committee. Once the optimal course of action has been collectively decided, Kofi and the team will then put together a transaction and execute it. Each time the process requires every professional from across the finance function to be at the top of their game, working as quickly and efficiently as possible. "We all work hand-in-hand," he says. "We have a very collaborative approach to delivering the best outcome for the organisation."

But just like it is for any top F1 racing team, continually delivering the best outcome demands an ongoing focus on improvement. Over the course of a world championship season, a team that doesn't constantly look for ways to optimise its performance and strategies to changing circumstances won't stay at the front of the grid for very long. Likewise for corporates, a treasury that does not adapt quickly to new economic realities as they develop will soon encounter all sorts of problems, particularly when it comes to risk management. An ability – and willingness – to devise new, creative approaches to get the best outcome in the conditions one is faced with is therefore essential. Never is there any room for complacency.

## Broader horizons

Developing innovative solutions to address complex financial problems is in fact something Kofi has been doing right from the onset of his career. After finishing a degree in mathematics at Brunel University, he determined that the best way to put his quantitative problem solving skills to work was in the field of finance. His first break came when he took on a role to review and develop retail finance models. But ever keen to broaden his horizons he enrolled, just a few years later, at the Cass Business School to study for a Master's Degree in Mathematical Trading and Finance. The thesis he would write on the subject of credit derivatives ultimately laid the foundations for his next career step: working as an analyst in a specialist unit of the Barclays audit function looking at risk models.

Back in the early years of the new millennium, the financial products Kofi had begun to specialise in were still relatively new and unusual. "I was looking at risk modelling of Collateralised Debt Obligations (CDOs) and basket Credit Default Swaps (CDSs) which at that time was a very exotic thing to be doing." It was an interesting avenue of financial derivatives, he recalls, but also incredibly challenging given the infamous opaqueness of the products he was modelling.

Kofi remained in the field of finance and financial modelling for seven years during which he increased his understanding of financial markets and market risk across a range of roles, gaining broader experience at financial institutions including Markit and Standard Bank. Then, finding himself once again keen for a new experience he resolved to make the leap over to the other side, spending a year and a half first as a Market Risk Manager at Emirates NBD in Dubai before joining in 2010. By now he had accumulated a broad set of experiences in different areas of finance and familiarity with a range of products across asset classes, something which, as we will explore later, is in his opinion a crucial ingredient to be successful in his profession.

## Mounting volatility

A good example of Kofi and his team's readiness to adapt his approach when circumstances change can be seen in how he and his team have reacted to current trends in foreign exchange markets. Recent signs of a strengthening recovery in the US have helped to trigger something of a bloodbath in emerging market (EM) currencies in recent months, particularly those in the 'Fragile Five' group, a quintet of EM currencies thought to be especially vulnerable to rising benchmark yields in the US. Naturally, hedging can be a challenging activity in these markets. The transfer of some currencies might be restricted by regulation; others hedges might entail a large negative carry (where the derivatives needed become prohibitively expensive). Some thinking outside of the box is usually required. "These

challenges mean one has to think about alternative and smarter ways of managing exposures,” says Kofi. After all, the last thing any risk manager wants to do in the current environment is compromise on hedging just because a market in which they operate has a challenging currency curve.

Volatility in any currency pair, particularly when there is an EM currency involved, is never helpful from a treasury perspective. Yet Kofi’s biggest risk concern relates not to any EM economy. Instead, the current trend that troubles him the most is the material decline recently witnessed in the euro. Having read a multitude of economic forecasts on the subject, he finds it difficult to imagine there being any rally in the currency over the near-term. “If you believe the US recovery story then you have, on the one hand an economy that is getting stronger and could see a rate hike at some point, and on the other, an economy that is going through quantitative easing. To me that is a concern. It has an impact on the market in terms of imports and exports, but also in terms of global growth.”

“You have to draw on many different sides of your experience to be successful in a field like this. If I had always been looking at interest rate risk, I would be struggling right now. If I only had experience relating to FX risk then it would be the same.”

How are financial risk managers like Kofi and his team adjusting their approach in light of recent events? Something which has become increasingly apparent of late, he explains, is that corporates can no longer depend upon the derivatives market alone to mitigate exposures. Natural hedges, if they can be found, always make a lot of sense, but particularly in the current environment. One method that is becoming more popular amongst treasurers involves the greater use of local liabilities, he says. “If I’m going to fund a business in an EM, instead of delivering the financing through my dollar funds, it often makes more sense to raise debt in that EM currency to fund the investment, thereby providing a huge degree of natural offset in terms of assets and liabilities to help mitigate that risk.”

There has also been a discernible shift away from the traditional, although in his view simplistic, approach to hedging in which exposures are mitigated almost exclusively using Foreign Exchange (FX) forwards. “If you look at the statistical analyses published on the effectiveness of FX forwards you will see that with EM currencies the instruments do not work very well,” he says. The problem is that, on average, EM currencies do not depreciate by as much as the forward risk premium implies. Consequently, any risk manager who is using forwards all the time ends up paying a lot for their hedging. “That has been proven time and again,” he says.

Other instruments, FX options, for instance, may be a more effective instrument for certain exposures. However, when there is a particularly steep forward curve, these instruments often become prohibitively expensive for the corporate. As such, there is no one single strategy that can be applied across the board. “You need to look closely at each currency pair you are exposed to and base your decision on that. This is

an issue a number of banks are conducting research into, and we are working with a number of them to find smarter ways of managing the risks, such as looking at each currency pair and then deciding what instrument works best.”

## The value of experience

In finding the right answers to such questions it is evidently beneficial for Kofi and the team that they can draw upon such varied risk management experience. As we have seen, Kofi has, during his career to date, made the transition from a retail finance role, to a derivatives models specialist at a bank, to an analyst at a derivatives house, to managing financial market risks. And since joining the Mubadala Group he has been able to expand his remit even further, growing from a quantitative and financial risk professional into a much broader treasury role.

Without that breadth of experience, he says, it would be very difficult to do the job he is doing today as effectively as he is. “You have to draw on many different sides of your experience to be successful in a field like this,” he says. “For example, if I had always been looking at interest rate risk, I would be struggling right now. If I only had experience relating to FX risk then it would be the same.”

But is Kofi content enough to cease in expanding his experience now? Not in the slightest. On the contrary, over the coming years he hopes that his role will allow him to take on responsibilities in new areas of corporate finance. Mubadala’s portfolio continues to grow, after all, so there is no shortage of opportunities to add to his experience by gaining insight into the risk management of other types of assets. Another option, he adds, would be to take on a broader finance role at one of the companies within the Mubadala Group.

A tenacious appetite to broaden one’s experience is something Kofi believes to be a crucial ingredient for success in any finance role. That many young finance professionals today tend to become pigeon-holed in one or several small niches can from his perspective be problematic, both in terms of the individual’s career development as well as for companies when it comes to recruitment.

“Ideally, when recruiting you want someone with a rounded treasury and risk background. But very often you will have candidates who have a specialist focus on cash management or FX.” What these candidates will often find, however, is that the skills developed in one particular role are transferable, if one has the right attitude. “If you have been doing Asset and Liability Management and you are a lateral thinker, you should be able to apply some of those techniques to other areas,” he says. “Making that transition can be a challenge, but if you want to succeed in this space it is absolutely imperative that you have an appreciation for all the various risk types.”

A parallel might be drawn once again with Kofi’s favourite motor sport. These days F1 teams can access an enormous range of telemetric data to assist them in setting up the car. But teams cannot rely on telemetry alone. The driver and his mechanics also need to draw on their own personal experiences to identify potential problems and generally support the decision making process. In the same way in treasury, the data rolling down the screen of Kofi’s treasury terminal is meaningless without there being people with the correct knowledge and expertise to interpret it. When there is a wealth of diverse experience to draw upon that is usually when treasuries – and F1 teams – are able to achieve the best results. ■



# Moving in waves

*Inefficient mobilisation of liquidity has a number of negative effects on corporate financial well-being, not least being increased risk. The good news for businesses is that there are several ways to hold a steady course in a rolling ocean of market uncertainty.*

In an economic environment beset by market volatility and low returns, global treasury operations are faced with a daunting task when it comes to optimising liquidity. Just trying to hold on to company cash when there are so many scenarios that are seemingly set on disrupting the peace may make the role of the treasurer feel a lot like sailing into the wind. For some, a downturn in orders from customers conspires with later payment receipts to threaten working capital stability. Even where sales orders have picked up in the wake of the financial crisis, the volatility of the markets and the all-time low yields experienced by most organisations continue to emphasise the 'normal' risks associated with the mobilisation of cash to create what for many must feel like waves of disruption.

Liquidity risk, credit risk, country risk, (even continent risk), currency risk, counterparty risk, tax risk and operational and compliance risk are all threats to the peaceable use of company funds in such circumstances. If it is considered then that many multinational businesses lack full transparency

and visibility over their cash structures, the level of exposure to these risks in the current economic environment presents a threat that must not be ignored.

## Drivers for change

Such uncertainty has served to push cash and liquidity management up the agenda to the point where they have become board-level issues, says Dennis Carey, Solution Consultant for cloud technology vendor, Reval. Where the concern is with idle cash (a "significant, unproductive asset"), the feeling, he notes, is that if the company doesn't do something with that cash, "then someone else certainly will." Indeed, a vast pool of idle cash can make a business a target for a takeover – will shareholders resist a buyer with plans to work that cash hard? But cash pools may be positive if used wisely.

They can, for example, be a means of unlocking working capital. Instead of borrowing in one location, it may be

possible to use the cash from one group operation to help fund another. Tackling the effective mobilisation of liquidity also facilitates more effective risk management. This could be from a counterparty risk perspective, ensuring not all eggs are in one basket, or from a foreign exchange risk management view where having a lot of cash in a particular currency exposes a business to fluctuations in that currency. “The idea of having cash where it is needed and not have it sitting idly by is very important,” states Carey.

Effective cash mobilisation is both a need and an opportunity, agrees Søren Kyhl, Global Head of Transaction Banking at Danske Bank. As the role of the corporate treasurer has become more strategic, so the need has risen to devote more resources to ensuring liquidity is in place at the right time, he says. But he acknowledges that this action faces difficulties in a low growth, low interest-rate environment where the competition in almost all industries is focused more intensely on cost. “Corporate treasurers are having to do more with less and this is driving the need to optimise processes and make sure they don’t have cash lying around,” he notes. “They need at all times to make use of all available opportunities.” The good news, he adds, is that there are “many more opportunities now,” aided by technology and even regulation (SEPA, he suggests is good example of the latter).

## Determining the right solution

“The first step to solving a problem is to admit you have one,” notes Carey. In the current environment, and with treasury under pressure to perform, this may be more readily admitted. However, the most appropriate solution very much depends on the specific situation. A programme of optimisation will need to consider in which countries the business is present, the currencies it is exposed to, its tax structure, the banks it uses and the various legal and regulatory points that may apply in (and perhaps between) each jurisdiction. In short, there is no one-size-fits-all solution.

Determining the most appropriate structure is thus a matter of asking the right questions, says Carey. This will start internally with tax, legal and operations functions, aiming to identify the challenges and pitfalls. And then, he says, it is a matter of working with banking partners “to get a consensus view” by taking a number of individual bank views and pinpointing the common themes.

Treasury consultants also have a key role to play in this process, especially tax and audit partners who possess the level of local expertise that may be beyond normal corporate understanding of areas such as thin capitalisation and transfer pricing. Regulatory matters will also arise, including exchange controls between currencies, central bank reporting requirements and bank capital testing. Of the latter, due to new capital adequacy rules in various jurisdictions, Carey explains that services like notional pooling may no longer make business sense for the banks.

The discovery process can be “a very cumbersome task,” says Kyhl. Talking to his clients, he can see that many are constrained on resources – not just budget but IT too – and are under pressure to keep costs down. He sees them re-assessing the efficiency of cash mobilisation on two fronts: “It will be the same issues and constraints that need to be investigated so we try to pull this together and advise on how to minimise costs on interest and working capital but also on how to streamline and save costs on internal processes and operations.”

## Internal and external solutions

Internally managed solutions range from an inter-company loans structure to a simpler means of enabling entities to identify and report their cash needs and excesses, and having a process in place to move group cash to where it is most needed. Corporates can also work with their banks to set up more formal physical or notional pooling structures, multi-lateral netting or virtual accounts (the latter currently for collections only). “A significant concern with cash is the number of inflows and outflows between affiliates,” says Carey. “Having a structured process in place to clear inter-company payables and receivables will move cash to where it belongs; having an affiliate with a lot of cash and that is not paying their inter-company requirements is a concern.”

More sophisticated formal structures include in-house banking. These started, and remain most prevalent, in Europe – but they are now gaining traction in other areas, particularly Asia Pacific. Although bank involvement remains necessary, a corporate treasury centre is used to manage operations from one place. More recently, these structures have seen the addition of a layer on top known as ‘payments on behalf of’ (POBO) or ‘collections on behalf of’ (COBO). This places the in-house bank as the corporate’s counterparty to its own external obligations. When in-house banking first started, each affiliate would pay its own bills and funnel the cash to the treasury centre. Now we are seeing the treasury centre paying the bills, so the cash never needs to move down to the affiliates.

## Know your cash

The dynamic nature of all these variables indicates that successful mobilisation of cash is an ongoing and long-term project. However, the first and most fundamental task is to be able to identify exactly where company cash is. Connecting treasury to the various entities within a group, and to the various banking partners, can be a challenge; of that there is no doubt. But as the development of web-based and SaaS/cloud technology progresses, so the ease with which connectivity can be improved increases. Being able to use data delivered by banks and affiliates in various formats via multiple communication methodologies is important. Being able to analyse the combined cash and risk elements is also a valuable part of effective mobilisation. It’s not only about how much the company has, but also how the amount, its location and accessibility affects the group’s consolidated results in terms of foreign exchange translation risk, counterparty risk and compliance with different regulations around cash and financial transactions, for example.

## Long-term challenge

Whilst there is no one-size-fits-all offering for effective mobilisation of liquidity, there is an optimum solution for each business. If identification of the remedy requires complete visibility over cash (not just the balances but also where it is and what impact that cash has on the business) then this is the point at which proven technology comes into play.

The ability to capture, analyse and understand the right information is possible with the right software and advisory partners, which includes both banks and vendors. “Just as we try to use regulation as a proactive source, we see technology in much the same way,” says Kyhl. “It’s not only about how we can create and offer new and better products but also about advising clients on how they can best use the potential that exists in new technologies.”



The creation of an effective liquidity mobilisation programme is a long-term challenge in which the goal-posts are likely to move subject to the many variables that affect liquidity. The dynamic nature of the task and the impossibility of knowing every market nuance is why external partners – consultants, audit firms, tax specialists, banks, and so on – tend to be involved on an ongoing basis with internal constituencies such as tax, legal, accounting, finance and treasury.

The fact that it is a long-term project also means it is unlikely to be executed in one go, says Carey. But businesses that have grasped the nettle and started to create coherent and connected structures will benefit from improved visibility over their cash positions. Simply knowing with accuracy the basics such as how much, where and in which currency at any given time can improve forecasting and facilitate the optimisation of investment returns. It may also reduce the need and cost of borrowing and transactional banking. Firms that have optimised their cash structure could improve foreign exchange hedging and other risk costs whilst better understanding their strategic use of cash through various corporate actions such as M&A, stock buyback and dividends. In effect, it makes businesses more competitive; as Kyhl points out, as long as the structure and technology implemented is able to grow with the project, treasury will be in a position to keep ahead of the wave. But when the regulatory environment and the technical infrastructure lacks homogeneity, the treasurer faces a different set of issues.

## Cash mobilisation in emerging economies

Trade in Africa represents an exciting opportunity for many corporates. Some of the 54 countries that make up the continent have the same – and in some cases better – levels of infrastructure and systems to assist financial movements, with full RTGS mechanisms, well-developed clearing houses that can handle electronic funds transfer (EFT), multi-currency transactions, direct debiting, and also home to more innovative payment solutions such as mobile money. But there are some that lag behind the rest of the world.

There is already significant corporate investment pouring in to all regions and the subsequent repatriation of funds represents a substantial volume of cash movement. But repatriation is not the only reason for mobilising liquidity in and out of Africa. “Often corporate treasurers are driven by a need to manage sovereign and currency risk by reducing exposure of their cash balances on the continent and putting them into more stable geographies,” explains Brendon Bouwer, Product Head of Liquidity Management & Account Services – Corporate and Investment Banking division, Standard Bank.

Most of the markets in Africa have transfer pricing rules and attendant withholding taxes. However, variability is the watchword in many other aspects of cash movement. Uganda allows free movement of funds across its borders whereas in Angola a company requires permission from the central bank to move its cash. In Kenya, it is possible to clear dollars, pounds, euros and Kenyan shillings through the local clearing house as a domestic electronic funds transfer, whereas in South Africa, domestic purchase of goods and services must be paid for in South African rand only.

With this issue in mind, there is a strengthening regional component to cash movement, says David Robinson, Product Head of Payments and Collections, Corporate and Investment

Banking division, Standard Bank. With the African Free Trade Zone overseeing the development of intra-regional trade co-operation, at the regional level, organisations include the 14-strong Southern African Development Community (SADC) which can facilitate (in most countries) same-day cross-border RTGS. The East African Community (EAC) is another regional intergovernmental organisation striving for a co-ordinated approach to trade and the movement of cash, with a regional RTGS implemented in certain EAC countries. Similar aims are held by the Economic Community of West African States (ECOWAS) and the Common Market for Eastern and Southern Africa (COMESA).

All are trying to create a movement similar the European SEPA model, forming a common payments infrastructure and encouraging freer trade amongst members. “It is still early days for these organisations,” says Robinson. He notes that unlike in Europe, the countries within these regional structures have not yet aligned regulations, such as exchange controls. They also do not share a common currency: SADC uses South Africa Rand as its settlement currency, while EAC uses or is planning to use all of the domestic EAC currencies, as well as USD, GBP and EUR.

Banks operating within this space don’t just need local understanding, they also must have the systems and the reach to be able to create solutions that fit this landscape. However, says Bouwer, there is also an issue with African countries wanting sovereignty and autonomy over these systems which means that when banks with regional footprints operate in their markets they want those systems to be localised. “Often it is not possible to run a service that uses a hub and spoke model; some authorities require the banking system to reside domestically and will put various restrictions on it to maintain control should there be a fall-out with the home country.”

Although the nature of the counterparty and the objective of a particular transaction will dictate the type of solution offered, these matters can combine to make the provision of domestic and cross-border movement of funds somewhat challenging for both bank and client. No bank in Africa reaches across the entire continent; Standard Bank is one of the largest, extending operations to around 18 of the 54 countries. But to reach further and facilitate transactions it has had to establish strategic correspondent banking relationships in what it calls ‘non-presence’ countries to allow those transactions to move into those markets. Nonetheless, he recognises that “nothing beats having a presence in-country and dealing with client needs in-house.”

For corporates entering the region, ‘traditional’ liquidity mobilisation solutions such as notional pooling and sweeping may be available, assuming local banking regulation will support it. Regardless of practical offering, the banking structure itself must be viewed in layers, advises Bouwer. Having created domestic and foreign currency accounts in each country, the localised structure should flow into a regional banking set-up which will ultimately flow into the client’s global banking structure. Typically, a business will establish a treasury unit in one of the regional co-operation zones mentioned above, taking advantage of relaxed exchange controls, foreign country movement reporting and so on. The need for on-the-ground help is perhaps more evident across Africa than in any other continent, says Bouwer. It is this knowledge that must be leveraged in the quest to optimise the mobilisation of liquidity. ■



# Getting to grips with VNAV

*New regulatory proposals set out for money market funds (MMFs) by the European Commission (EC) earlier this year are set to radically reshape the trillion dollar industry. But perhaps not in the way that a lot of people anticipated.*

Over the last several years the money fund industry in Europe has been shrinking. Every year since 2012, data has shown the total number of funds to be in decline. With far from universally favoured regulatory proposals in the offing, together with the negative interest rate environment, many in the industry thought that that this decline would accelerate further still in the coming months and years. They may have spoken a bit too soon.

Conversations Treasury Today has recently had with European asset managers indicate that the coming regulatory shake up may well preclude a growth in MMF products, albeit by means of the assets already held in prime CNAV MMFs being reallocated into various smaller funds.

Retail and government constant net asset value (CNAV) MMFs will remain on the menu for the time being. The big news, however, is that an entirely new category of fund will be established subject to a five year sunset clause: Low Volatility

(LVNAV) MMFs that will be required to publish their mark-to-market daily and remain within a 20 bps range. As asset managers endeavour to establish new funds compliant with the regulations, treasurers may soon have much more to choose between when it comes to investment vehicles for their cash investments.

“What is clear is that MMF providers will have the ability to offer a wider range of products to suit their client base”, says Ian Lloyd Senior Business Manager for Liquidity at Legal and General Investment Management (LGIM). “I think it is clear that all managers running CNAV’s will be considering LVNAV and government MMF’s. The current product offering is very commoditised, as we move forward I expect to see a wider range of products. Where we’ve got a flagship sterling fund – which today stands at circa £23bn, it is likely that this could end up split into a Government fund, a LVNAV and a VNAV product. The ultimate size of the respective funds will be based on investor appetite.”

## Less than zero

Corporates are facing an exceptionally challenging investment environment in Europe at the moment – one which actually has little to do with the forthcoming regulatory changes being imposed upon the money market fund industry. The recent monetary policy stance of the European Central Bank (ECB), in particular the decision to slash its deposit rate to minus 20 basis points is driving yields on virtually all euro-denominated MMFs into negative territory. Treasurers, none of whom are feeling overly enthusiastic about the idea of paying for their liquidity (which thanks in part to the recent bond issuance frenzy is at extraordinarily high levels), have been re-considering their options.

“Like many other corporates, we are not currently using euro denominated money funds due to the yield, rather than the new regulation issues,” says Andy Nash, Senior Vice President and Group Treasurer at the Dutch international retailer Ahold. Compounding the problem is that, in Europe at least, there are almost no other liquidity vehicles able to provide a positive yield without sacrificing the other two elements of that impossible short-term investment trinity, security and liquidity. It’s of little surprise, then, that those who are able to are keeping their cash elsewhere.

Ahold is quite fortunate in the respect that 60% of its business is in the US and has US dollar cash which can be invested in a better yield environment including dollar money market funds. It is also possible to manage the FX risk from dollars to euros but this entails taking a different approach to asset liability management. “Normally you would be much more focused on having a balance between dollar assets and liabilities. But in today’s environment it is much better to actively manage the FX and keep more dollar cash, ensuring the FX is managed for euro needs. It also means being very strong on cash flow forecasting and understanding how far you can term out.”

Any new funds that are established may very well, in the current environment, be attractive propositions for corporates relative to bank deposits (depending, of course, on how security, liquidity and yield are prioritised). Contrary to expectations, neither regulatory uncertainty nor free-falling interest rates have precipitated substantial outflows from the industry. “You need to be careful looking at combined asset flows in euro terms because of the euro depreciation, but the actual flow into CNAV MMFs in sterling, euro and dollar terms over the last year have all been positive,” says James Finch, Head of Global Liquidity Management, EMEA at UBS. “Even in the US asset levels have actually been higher since their regulatory measures were announced. Everyone was slightly pessimistic, saying that it would lead to outflows from the industry but it hasn’t – it has, in fact, been the reverse.”

“Like many other corporates, we are not currently using euro denominated money funds due to the yield, rather than the new regulation issues.”

Andy Nash, Senior Vice President and Group Treasurer, Ahold

Like LGIM, there are already plans in place at UBS to grow their liquidity fund product range. Initially, they plan to launch a range of traditional CNAV funds in Ireland to complement the VNAV funds they are running already in Switzerland and elsewhere in mainland Europe. Once the regulation is agreed these newly established CNAVs will be amended accordingly. “At UBS we are going to be building out our product range in the short-term MMF space,” says Finch. “If you look at ourselves – and the other providers – we want to have a range of solutions from potentially CNAV retail or government only, through to LVNAV and VNAV funds. From the client’s perspective, they are going to have a range of different products to choose from. The demand is still going to be there for high-quality short-term MMFs that settle on a same day basis, so we will be trying to take the things that investors find most attractive about CNAV MMFs and deliver them in a new regulatory environment.”

Even the impact of negative yields, which many treasurers cite as a greater concern than regulation, appears to be more nuanced than some anticipated.

## Nowhere to turn

Why have those expected outflows not materialised? After all, IMMFA estimates that a majority (57%) of all euro area MMF assets are held in CNAV funds. These are evidently very popular investment vehicles, and given that regulation means they are set to vanish from the European market one might expect some investors to take their liquidity elsewhere.

One of the problems with that reasoning is that it works on the assumption that there are plenty of other viable vessels out there waiting for corporate liquidity. There simply are not. In reality, the alternatives on the market are few and far between. Although bank deposits might serve as a feasible option, for some (if they can stomach the even more negatively yielding deposit rates), the introduction of Liquidity Coverage Ratio has seen to it that non-operational deposits are now being actively discouraged by some institutions. Segregated mandates have some benefits for exceptionally cash rich corporates, but are more or less impractical for everyone else. Another possibility might be an Exchange Traded Fund (ETF), but any treasurer who goes down that route would have to be willing to tolerate longer durations and, by extension of that, higher levels of risk.

## Stability by other means

For corporate investors, however, MMFs remain the preferred option. The fact that a large slice of the market could be obliged to convert to VNAV – albeit over a long period – may in fact be immaterial to many. Investment policies may need to change in some cases; tax and accounting treatment may for some prove more challenging, but even so the anecdotal evidence suggests that most treasurers understand now that VNAV does not necessarily equate to volatility.

It all depends on how the fund is managed. Anybody who still doubts this should take a look at the liquidity fund offerings of Aviva Investors which were converted to VNAV back in the

aftermath of Lehman Brothers. “The valuation of our daily sterling liquidity fund over the past seven years has never moved away from one,” says Matthew Tatnell, Head of Liquidity at Aviva Investors. “If a cash fund is managed in accordance with its stated objective of maintaining a £1 share price then there should be little or no volatility in normal market conditions. The term VNAV can in fact be used as a label for a very wide range of different ‘cash’ investment styles that certainly don’t all set out to provide a stable asset value, high amounts of liquidity and low credit risk.”

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Aviva has been able to achieve this share-price stability simply by managing their funds in a more conservative fashion, prohibiting the purchase of higher yielding floating-rate notes, for example where historically prices can be volatile, preferring instead to offer this type of product in a separate AAA-rated fund that doesn’t target a stable asset value. Of course, in extremely stressed market conditions the value of the fund’s portfolio could decline and that would show in the share price. That would happen to any investment fund though, regardless of what label one puts on it. The difference is that, when faced with such conditions, the ability of the share price to fluctuate helps to keep the fund open for business.

In contrast, when a CNAV MMF is faced with such market conditions it could, in the absence of sponsor support, be forced to wind down. In this extreme situation, the investor could potentially experience a long, nervous wait to see how much of the investment will be repaid as the fund sponsor attempts to sell off the portfolio into a market that, in all likelihood, is already stressed. “I actually think this whole VNAV and CNAV differentiation is irrelevant,” says Colin Cookson, Managing Director of Liquidity at Aviva Investors. “Just because you put a label on something doesn’t mean it’s immune. Instead investors should be thinking about how the sponsor is managing the portfolio to minimise the probability of a potential for a move in the NAV.”

## Decisions, decisions

As noted earlier, treasurers in the post-regulation European MMF landscape are likely to have considerably more choice in terms of products. But what type of fund will ultimately end up being the most popular choice for the corporate investor? With the expectation being for so long that it would be VNAV or nothing for European MMFs, some of those who formerly invested in the other category of fund have been busy readying themselves for VNAV, considering how such investments and removing any potential obstacles ahead of time. Many of them may also be looking at the more stable incarnations of VNAV MMFs, as run by the likes of Aviva and Northern Trust, and reaching the conclusion that this type of

product, if managed in the right way, might not be so incompatible with their investment needs after all.

On that basis, LGIM’s Lloyd believes that the bulk of corporate liquidity may eventually end up heading in the VNAV direction. “It may well be that VNAV over time becomes the preferred choice for corporate treasurers, especially given the LVNAV sunset clause. If that is indeed the case, how does Lloyd see all of those CNAV-only fund investors adjusting? “To begin with investors will have to get used to the mechanics of a VNAV but given the underlying investment guidelines are unlikely to change dramatically it is likely that over time corporate treasurers will become comfortable with this product.”

UBS’s Finch agrees, adding that the now-visible volatility will also entail changes in accounting methodologies and, possibly, updates to TMSs and other relevant systems. “If treasurers are used to CNAV funds then changes in the underlying NAV will make it somewhat different in terms of the accounting or how they book it into their systems.” Providing the introduction of LVNAV MMFs is confirmed in legislation later in the year, however, treasurers will at least have time on their side. “That should be a kind of stepping stone product,” he says. “It will look and act like a CNAV product and will provide clients with similar benefits.”

Straightforward, easy to book and report on a tax basis; it is not difficult to understand why prime CNAV MMFs have long been popular investment vehicles, for corporate treasurers especially. However, ever since the bankruptcy of Lehman Brothers caused the Reserve Primary Fund to “break the buck”, regulators have had the industry in their crosshairs. Now, rightly or wrongly they have decided that in the interests of financial stability they should be phased out. That is the reality facing investors. For those who prefer their NAVs fixed at a price of one it is not an ideal reality, yet in the current environment it is hard to see many corporates discontinuing or even reducing their use of MMFs once the regulation is finally passed into law.

“Just because you put a label on something doesn’t mean it’s immune. Instead investors should be thinking about how the sponsor is managing the portfolio to minimise the probability of a potential for a move in the NAV.”

Colin Cookson, Managing Director of Liquidity, Aviva Investors

Even when the HSBC Euro Liquidity Fund became the first multi-billion fund in Europe to post a negative yield back in April it proved to be very much a storm in a teacup. Moody’s said at the time that even though it expected more of the MMF sector to turn negative in the weeks ahead, this would likely only result in reallocations within the sector, not outflows.

That should give everyone an idea of prospects for the industry going forward. If the notion of paying to deposit liquidity proved insufficient to drive investors out of the MMF space, it seems somewhat unlikely that changes to how funds account for capital and income, and value their underlying investments, will. ■



# A day in the life: interim treasury

*For the interim treasurer, a number of skills must fall into place to be a success. It can be hard work finding the next assignment but the rewards both financially and in terms of job satisfaction can make it all worthwhile. What pleasures and pains does the role hold for practitioners?*

There is no doubt that the life of the interim treasurer has its up and downs and would not suit anyone who needs security in their working life. But the very nature of interim is such that change is inevitable and from one assignment to the next the exponent will never really know what to expect until that assignment is agreed. But for those that make a living this way, this is part of the attraction.

## Finding the next assignment

The next assignment – whatever and wherever it may be – could arrive in a number of ways and for the seasoned professional it could even be just a news item away. All treasurers need to understand the relationship between business and the rest of the

world and paying attention to the news can inform of sudden developments in other regions or countries that require immediate attention to protect the company from on- and off-balance sheet financial risks (such as FX risk). But for the proactive interim treasurer, a news item could be the cue for the next assignment.

Although around 50% of his work comes via major recruitment agencies such as Michael Page or Krongaard, interim treasurer, Thomas Stahr says many of the assignments he takes are the result of regularly searching news items, looking for signs of a treasury in need of assistance. “If I read the comment of a CFO who says his company improved sales but, because of exchange rates, it actually reported a loss, I see that as a signal to get in touch,” he explains.

Sometimes this speculative approach yields a new assignment, sometimes not – a claimed ‘hit rate’ of around 20% seems like a positive result and Stahr agrees that it works well for him. The news is but one alternative source and Stahr reveals that he also keeps a watching brief on the job advertisements for permanent treasurers. “If I see the same advert for three or four weeks I will contact the company and offer my interim services.”

It is this level of resourcefulness that keeps the interim in the game but cannot be the only source of assignments. Being in a position to trade on a solid reputation and owning an impressive contacts book also plays an important part in securing the next job, says Erik Teiken, an interim treasurer also of many years’ experience. Of course, it takes time to build a reputation, so for the new interim he suggests working closely with the main recruitment bureaux that have a stated interest in the interim world, such as the two mentioned above and the likes of Robert Walters and MR Recruitment. The larger players, he notes, will have more locations and corporate connections and more staff to work on behalf of its clients but he says do not dismiss contacting the smaller agencies that handle treasury recruitment as these will potentially offer a more personalised approach to your search. “When I’m looking I call them all, frequently. If I’m on an assignment I always tell them when I will be available again. Once you’re in their system everyone in that bureaux should know it.”

It will be presumed that the prospective interim has accumulated a number of years’ professional experience in various branches of treasury and finance before deciding to take the new route. To get started it will be useful to begin calling upon contacts made over the years – in the corporate, banking and technology sectors and even through the national associations of corporate treasurers (ACTs). A concerted effort in this respect will alert the community to the fact that the new interim’s services are now available for hire. It is a good idea also to keep notes on each contact and build a file of what was said and when; it makes it easier when approaching them again.

## Stand out

There is an element of competition in seeking an assignment, warns Teiken. Whoever submits the application first will stand a greater chance than all the others – so speed is of the essence. But the right match of skills is the final decider. It is very hard and perhaps even impossible to become an interim treasurer without first having solid experience on the payroll of a corporate. The addition of relevant professional and academic qualifications count almost as much as experience in this highly competitive space. In terms of their education, training and event opportunities, the various national treasury associations can help all treasurers broaden and validate their skills.

The bad news is that with the banking industry losing many jobs over the past few years, there are entrants now from this arena too. These people may not be treasurers per se but, as Jean-Claude Jossart, an interim with 13 years’ interim experience under his belt says of this situation, “the main enemy of the banks today are former bankers.” Knowing most of the tricks of the trade and the constraints that the banks face will stand them in good stead in the interim world.

Indeed, Jossart worked for 20 years as a corporate banker (in front, middle and back office) before entering group treasury.

He knows only too well that a business looking to manage its banking relationships would be well-armed indeed with such inside-knowledge on-board. But the point to understand here, he says, is that treasurers need to acquire a broader range of skills and knowledge than ever before to stand out. The more widely experienced and qualified the individual, and the better the contact list, the better the chances of securing the best paid and most interesting assignments. “Interims need to work out their own approach to the market,” he says, but adds that today, being known as a very good professional is no longer enough. “Flexibility is important and you need to be ready to work on the international market if you want the most interesting mandates.”

## The first days

Having secured a new assignment, depending on the actual mandate (it may be operational or more strategic), one of the first duties of the interim is to be introduced to immediate colleagues and then to extend this out as far as possible to those within the wider group that have connections with treasury. The arrival of an interim treasurer may, says Jossart, be best initially announced via internal messaging/intranet so that even staff who are not immediately connected with the assignment are fully aware of what is happening. This can help establish the interim with the necessary authority, setting forth the plans and avoiding potential conflicts and misunderstandings.

The first practical task should be to carry out an assessment of the structure and culture of the organisation, to get a feel for how things are done and how they could be done under the auspices of the assignment and in line with the competences of the people involved. It may be necessary to try to map out the existing IT system and treasury-specific technologies at least as they relate to the reporting content and structure. Grasping the status quo is essential to secure the resources available for the assignment – including the co-operation of all external partners such as banks and technology vendors – and will almost certainly be part of any project-based mandate.

An assignment is not just a practical exercise. Interims “really have to care about the requirements of those above, below and around you in the hierarchy,” states Stahr. Managing change is almost inevitable for an interim but these changes should, wherever possible, be seen as “new opportunities.” He acknowledges that change is not always seen in such a positive light by existing employees and as such the work of an interim may face some resistance. If this is the case it will usually appear at lower levels of the company hierarchy. “You frequently have to take care of these people first because they are the basis of the business – you cannot work without their support,” he advises.

Although he acknowledges that “everybody knows you are only temporary” and that the regular employees will always assess interims as such, Teiken believes that most of the time the individual will be accorded the professional respect they deserve. Whilst never having had any real confrontation to deal with, he notes that if someone does not want to co-operate, for whatever reason, there are always ways to “encourage” their involvement. “It is about getting everyone in line; after all, we are all working towards the same result.”

Contracts may last for a few weeks or extend to a year or more. A short-term assignment can sometimes develop into

a longer-term involvement if project scope is allowed to creep (as distinct from necessary additions to allow the work to be executed fully). “Many times at the start it is not clear what the exact scope of the assignment is,” notes Teiken. “It will be discussed with the management on day one but an interim has to widen and deepen that conversation, finding out where the boundaries are, defining the goals and expected results.”

## Handing over

As an interim, there will come a time when an assignment must end. An experienced and effective operator will frequently be approached by the employer with an offer of full-time employment. This may be of interest but really, says Stahr, the focus from the outset should only be on completing the task at hand. “Don’t think about starting work that you know you have no chance of completing within the agreed time; the project must always come first.” In any case, he says, most professional interims would probably prefer to live with “all the advantages and constraints” of their chosen path.

There is thus a clear need to define an end-point and prepare for the handover. “Do not underestimate the effort required for this very relevant exercise,” states Jossart. In fact, preparation for handover should commence right at the start: setting up documentation that tracks progress, including any changes will enable the interim not only to check that the assignment has been fully met but also aids handover to a successor at the end.

Writing very clear guidelines and explaining what has been achieved in the project is part of the procedure. Detailed notes should aim to re-assert the goals set at the beginning, offering analysis and advice on all changes that have been implemented. For Jossart, this document should be submitted at least four weeks prior to the end-date, allowing time for additional meetings with relevant parts of the business to ensure everyone understands the impact of the work carried out and that there is agreement that it has been executed effectively.

Once an assignment has concluded it is quite common for an interim to keep the dialogue going with the company. “In most cases it does not end with the last day; I always remain in contact with my successor and with the people who hired me,” says Stahr. References from each assignment (assuming it was successful) will build up credibility and aid the process of securing each new job. But be warned: “You’re only as good as your last three years or five assignments,” says Teiken.

## Advice from the professionals

Enthusiasm for, and a deep and ever-expanding knowledge of the subject is an essential part of successful interim work. “Try to define your own level of competence versus market needs; treasury is subject to constant evolution so try to propose the optimal match,” advises Jossart. Up to the minute technical skills and broad practical experience are vital and should be augmented with formal study (industry and academic) and additional certification such as PRINCE2 for project leadership is a bonus. Development of soft skills, such as change management or negotiation skills, are also a necessary part of continued success in this field, he says. The interim must also be able to listen attentively but never be

afraid to ask the client for a clear profile of what they want: the success of the assignment is paramount.

When tackling an assignment, always be open-minded and see every change as a new opportunity, “but don’t try to change too much in the first few days and weeks,” advises Stahr. He believes that it is essential to respect the employees and that the interim should always try to put themselves in the position of every colleague, regardless of the function in which they are employed. “Try to put yourself in the position of the people around you, what they might think about you, the work you do, the organisation and so on,” he says. “Understand that communication is everything.”

The chance to work in many different types of businesses, meet new people, constantly learn new skills and, potentially, earn more than a salaried treasury position suggests that interim is the ideal treasury job, and for some it is. It comes with one major caveat: “It can be a risky job, with sometimes no assignment for several months,” warns Stahr. Under normal circumstances a gap of a couple of weeks might be engineered purposefully by the interim to refresh before starting the next role; this is not always an option, especially in mainland Europe. “It was a really hard time just after the financial crisis hit,” admits Jossart. Today, as the Eurozone crisis continues unabated, there is still market caution on the continent. “It’s tough at the moment,” he muses.

## Market pressure

Conditions are exacerbated by the flood of cheaper resources on the market. Indeed, with many non-treasury corporate finance professionals and corporate bankers having lost their jobs due to cutbacks they are naturally seeking a living from what they know; the interim space is a natural attraction. For every interim, staying competitive is essential and this means keeping contacts, skills and knowledge up to date and remaining proactive and flexible in the search for work. “You must remain active in the market otherwise people will forget you,” urges Jossart. “But you must consider that there will be times when you are not being paid.” However, with fewer jobs and more candidates, the rates of pay have dropped by up to 35%, at least in mainland Europe, he warns.

A typical rate for an experienced and well-qualified interim would be around half of the rate for partner-level advisory services from one of the Big Four consultancies, says Stahr. Curiously, working for a large and well-known business can actually see the daily rate drop slightly: “the better the reputation, the lower the rate,” he comments. These companies know that they can pay slightly less because the interims they employ are subsequently able to leverage the credibility afforded to them by such an assignment. The reverse is true of course for less well-known corporates and slightly higher rates may be commanded.

Despite the risks and uncertainties, the lifestyle of the interim treasurer is one that its best exponents swear by. “You can achieve great success in a very short time; you can improve something and make many people happy – not just those in the department but even up to shareholder level – and this can be a great feeling,” says Stahr. Permanent treasurers may also experience the joys of success, of course, but as an interim you have a ready-made goal and the mandate to go ahead and make a difference. ■



## A double-edged sword

*Much has been written about the ‘unintended consequences’ of regulation and our Editorial this month looks at the problem of over-regulation. Yet little has been said about the benefits. Can key regulatory reforms really bring anything positive to the treasury environment? On that topic, the response from treasury experts, it seems, is rather mixed.*

EMIR, Dodd-Frank, SEPA, FATCA, the list goes on. Regulation has been a heavy burden for most treasurers over the last few years; and that’s not even considering the indirect impact of changes in the banking sector. In fact, regulatory compliance is “an increasing overhead, some of which is a tick in the box exercise and, thus, doesn’t add any value.” That was the candid opinion of one respondent to Treasury Today’s 2014 European Corporate Treasury Benchmarking Study – and many other treasurers hold similar views. “I prefer to remain polite and not comment on valueless, EMIR-like constraints,” said another.

Whilst the negative effects of regulation are not in question, it is perhaps pertinent to ask whether corporates are benefitting – either directly or indirectly – from these initiatives.

### EMIR as a starter for ten

Designed to standardise over the counter (OTC) derivative markets across EU countries as well as improve transparency

and mitigate systematic risk, the mandatory clearing requirements of European Market Infrastructure Regulation (EMIR) are, at the time of writing, still being finalised by the European Securities and Markets Authority (ESMA). The current draft requires corporates – that are already, or planning to become, central counterparty clearing house (CCP) members – to clear six months from the date when the legislation comes into force.

“Interest rates clearing legislation is expected to be completed first and come into effect in the third or fourth quarter of this year, with credit derivatives to follow,” says Olga Cileckova, Director at PwC. “If corporates are already clearing members or looking for direct access to CCPs, one assumes they are already voluntarily clearing most standardised contracts.”

The current clearing draft legislation also proposes a three year transition period for non-financial counterparties that are currently not clearing members but have OTC derivative



activity above the clearing threshold. “While 2018 seems a long way off, there are reasons for corporates subject to clearing to be taking an interest now to assess the clearing options that will be available to them, the cost of clearing access and development of the legislation,” adds Cileckova. “Clearing services are expected to be impacted by the banking regulations, in particular Basel III.”

The corporate community has largely been shielded from the impact of OTC derivatives regulation in Europe thus far – delegated trade reporting is permitted and regulation of non-financial counterparties has been less onerous than for banks, observes Senior Analyst at Aite Group, Virginie O’Shea. Due to the extensive delays and revisions to EMIR, many corporates have held off on preparing for clearing requirements.

The biggest challenge for these firms is a lack of internal expertise on the practice of clearing, she adds. “Banks have been exposed to these requirements and challenges before, but corporates are not financial operations or compliance experts. The numerous problems that regulators have encountered in making sense of trade reporting data have not helped matters – there is general sentiment that reporting infractions will be almost impossible to detect for the next year or so.”

## Varying degrees

The inclusion of a phased approach to EMIR has been helpful, although the rules are still capturing a large number of corporate clients with varying degrees of sophistication says Chris Probert, Managing Principal, Capco. “Traditionally, these clients’ systems and processes have been less automated. Trades which may be seen as straight through processing for a multinational broker dealer could be manual for corporates, which presents them with operational and IT challenges to ensure they can meet their obligations.”

Aside from the technical challenges associated with clearing, there is the considerable administrative task involved in the process, he continues. “Corporates need to decide who will be their clearing broker and backup broker; what (if any) market infrastructure they will use; and how they would like their margin to be segregated, along with a wide range of other decisions. These decisions and the related paperwork take time.”

Probert suggests that the wide range of corporates impacted by clearing rules makes it impossible to label the whole group as either prepared or not. “Undoubtedly the larger, more sophisticated corporates (who may already be clearing) are in the main part ready. The issue is with the smaller corporates who have traditionally have been slow to react to regulatory changes and are likely to be up against the clock to get everything ready in time.”

Deloitte’s Treasury Advisory Service co-leader Karlien Porre, however, points out that while corporates have to comply with reporting and risk mitigation components of EMIR, most are exempt from its clearing requirements since they are classified as non-financial counterparties.

And on the subject of the upside of EMIR for corporates, she notes that “some companies would see compliance as a cost rather than a source of benefit. The real benefit is improved financial market stability.” On a counter note, Jan Vermeer, Partner and Founder of Treasury Services describes EMIR (and Basel III) as having contributed to higher banking costs

for corporates who are determining their bank relationships based on a RAROC or risk adjusted return on capital model.

## Basel III: the knock-on effect

One of the most significant but least-discussed regulatory changes that will impact corporate users of treasury management services is Basel III, explains Daniel Blumen, Partner at Treasury Alliance Group: “There is a direct connection between balance sheet changes the banks are making and the cost and availability of treasury services. Most corporates don’t know their banks’ position and so cannot act to take advantage of the changes or mitigate their impact,” he explains.

Furthermore, “while Basel III has prompted changes in banking services, particularly driven by the liquidity rules, the expectation of many corporates is that there will be more changes to come around treasury services, credit/liquidity facilities and ‘non-operational’ deposits,” says Robert Ceske, Principal and Head of KPMG’s US treasury practice.

One of the problems is that the banks are not yet talking to their clients, which keeps the issue off the radar of many corporates, Ceske suggests. “There will be significant shifts in business allocation and restructured credit facilities by corporates as the impact becomes clearer. The smarter ones are taking action now but this issue will be at the top of treasury discussions later this year.”

In some cases, Basel III has led to credit lines being tied up and banks asking clients to deposit for a period longer than three months, explains Cileckova, while in other areas – such as pricing of high frequency, low volume derivatives – the impact is less transparent. According to Enrico Camerinelli, also a Senior Analyst at Aite, the regulation has made users of corporate banking services more knowledgeable on how their bank partners are handling the compliance requirements. “Bank relationship management is becoming a must-have practice to assess whether banks have charged/are charging costs of compliance to corporate clients.”

Banks are still working on Basel III implementation and there has been little price impact on corporates due to competitive financial markets – that is the view of Dino Nicolaides, Deloitte Treasury Advisory Services co-leader. “There has been limited impact on lending, although we have seen more UK and European corporates accessing capital markets directly for funding as opposed to the loan market, which is a shift towards the US model. Some argue that the financial crisis and Basel III have accelerated this process.”

Another possible implication for corporates is that banks may decide either that they no longer want their business because they are either over-exposed to the company or that the mix of business done with the company has to change. “In the past, the bank would only have to consider counterparty risk,” explains Jerry Norton, Vice President Financial Services at CGI. “Now it has to look at the liquidity coverage ratio and the leverage ratio and understand the impact of corporate activity across its book. In some cases this might mean the bank will favour business from a specific industry sector or drop certain types of business.”

It’s not all bad news though. Neil Vernon, CTO Gresham Computing believes the opportunity to reduce their capital adequacy requirements has encouraged banks to take a closer look at how they can better serve their customers’ needs and that they are delivering better service and more innovative products as a result.

## The lowdown on money market funds

In addition to pending clarity of EMIR and increased discussion of Basel III, corporates had been waiting for further clarity on the changes to European money market funds (MMFs) regulation – which was announced in March. See our article focusing more in-depth on the implications of new European MMF regulation on page 24 of this issue.

## Ring-fencing in the UK

Of specific regulatory consideration for UK corporates is the Bank of England Prudential Regulation Authority's (PRA) implementation of ring-fencing of core UK financial services and activities for banking groups with core deposits in excess of £25bn. The government has stated its intention for ring-fencing to take effect from the 1<sup>st</sup> January 2019. The PRA has acknowledged that this is of interest to customers of the affected banks and intends to undertake further consultations during 2015 and publish final rules and supervisory statements in 2016 to provide firms with sufficient time for implementation.

"There are concerns among corporates that they might have to change sort codes and other account details if their business was moved into the part of their bank that is not ring-fenced," explains Norton. Elsewhere, some smaller companies will find themselves dealing with the ring-fenced bank (RFB), yet the derivatives offered by the RFB will be limited and will not necessarily cover all their hedging needs.

## SEPA trundles on

Finally, SEPA continues to be a headache for many corporates. Not least because all the hard work does not seem to be paying off yet, especially for the smaller players. "Some of the larger, pan-European companies have also yet to reap the returns on their considerable investments, although improvements in terms of process standardisation and lower banking costs are starting to filter through," confirms Norton. He says these improvements are being felt most keenly by corporations with significant business-to-consumer operations, including utilities, mobile operators and insurance companies.

But opinions about SEPA improvements – and limitations – going forward are somewhat split. Magnus Carlsson, Manager of Treasury & Payments at the Association for Financial Professionals, focuses on one of the practical limitations of SEPA, namely the size restriction for a payment to only 140 characters. "This means that instead of sending payments for multiple invoices in one transaction, corporates have to use one transaction per invoice. So even if the cost per invoice was considerably lower, the overall cost for sending payments could very well be greater than with the legacy system."

However, KPMG's Finance & Treasury Management Partner in Germany, Carsten Jaekel, takes a more positive view and suggests that many corporate customers now have a better understanding of the benefit of single formats. For him, the Common Global Implementation initiative will build on the foundation laid by SEPA and eventually lead to significant savings from fully-fledged payment and collection factories. According to Cileckova, SEPA has made the euro payment

system more efficient overall – leading to savings in transaction costs – and that many companies are now focusing on the second round of SEPA optimisation when the new Payments Services Directive becomes a pressing implementation issue.

Benefits of SEPA for corporates include: a wider portfolio of banks to process their payments business, increased pricing competition, cost benefits from optimised and standardised enterprise resource planning (ERP) bank interfaces using the ISO 20022 standard for payments and account information services. SEPA is also improving straight through reconciliation capabilities by enriched data carried in the messages and has introduced the direct debit payments instrument in order to collect funds centrally across all countries and customer accounts.

"However, as a result of the financial crisis, many corporates have become very risk conscious and reluctant to consolidate their payments business with a single bank and location within Europe, so this obvious benefit has rarely been implemented," suggests Capco Partner Bernd Richter. Camerinelli also acknowledges that although use of the ISO 20022 standard allows for the alignment of payments transactions in all SEPA countries, it is yet to be fully exploited.

"There are concerns among corporates that they might have to change sort codes and other account details if their business was moved into the part of their bank that is not ring-fenced."

Jerry Norton, Vice President Financial Services, CGI

Elsewhere in SEPA-land, in December 2014, the Euro Retail Payments Board (ERPB) decided to step up work on instant payments, person-to-person mobile payments and contactless payments as well as issuing a set of recommendations to address outstanding issues in the SEPA credit transfer and direct debit schemes, such as the move to IBAN only and the harmonisation of payment standards between banks and customers.

The ERPB is concerned that the emergence of new solutions might end up creating a fragmented market in Europe for instant payments. "Solutions for instant payments should avoid the 'silo' mentality of closed systems that don't communicate with each other and take advantage of the harmonisation and integration already achieved with the SEPA project," says Yves Mersch, member of the ECB's executive board and chair of the ERPB.

## Always look on the bright side

In the midst of the headache that regulation can be, and with so many conflicting opinions to take on board, it is often difficult to see the silver lining. But as Mersch alludes to, taking advantage of regulatory benefits, or at least opportunities, is something all corporates must strive to do. And although the regulatory burden is not likely to lighten in the near future, in some areas at least, corporates can look forward to their hard work delivering worthwhile rewards. ■



# How to ace an RFP

*Whether you're looking for new services and banking partners or updating current systems, a Request for Proposal (RFP) is a core stage in any tendering process. In this article, we look at the building blocks behind drafting, issuing and analysing a best-in-class RFP.*

In the world of corporate treasury, there are few 'one-size-fits-all' solutions. When looking to implement or update a particular element of the treasury set-up, be it a multi-currency pooling structure or a Treasury Management System (TMS), a choice will need to be made concerning which solution is selected and from whom.

A well-managed request for proposal (RFP) can therefore be an invaluable tool available to the treasurer that – if used correctly – can ease the selection process, and highlight the often nuanced differences between the solutions. And while the RFP process can take time and consume resources, it can provide far better results than an unstructured approach.

In order to simplify the RFP process, it can broadly be broken down into four key stages:

1. Understanding the requirements of the project.
2. Drafting the RFP.

3. Issuing the RFP.
4. Evaluation and analysis of responses.

This article will look at what needs to be done during each of these four stages in order to construct a best-in-class RFP.

## Building a clear picture

The first stage of the RFP process is arguably the most important and the work done here will have a significant impact on the success of the rest of the project. It is at this stage that the treasury will analyse and document its current processes and technology, in order to develop an intimate understanding of them and highlight the issues that need to be solved when implementing the new solution. This analysis will allow the treasury to build a list of key objectives for the project and an outline of how these can be achieved – this will provide a foundation for the rest of the project.

Of course, in many cases it will not just be the treasury that will be impacted by the new solution or service; it is essential to think carefully about which other functions will be affected, if they should be involved in the consultation processes and who could or should benefit. Completing this analysis will allow the treasury to understand who the key stakeholders are.

The first stage of the RFP process is arguably the most important and the work done here will have a significant impact on the success of the rest of the project.

At this stage, the treasury may also want to begin developing an understanding of the strengths and weaknesses of the banks/vendors that they are likely to send the RFP to. While there are many ways that this can be achieved, some of the most common include: attending industry conferences and events hosted by the banks, having informal conversations with other treasurers, using industry studies (such as Treasury Today's Corporate Treasury Benchmarking Studies) that rank the banks in a number of different areas, and by reading industry publications.

The banks can be contacted directly in these initial stages. For example, it may be a useful exercise to submit a Request for Information (RFI) to some banks that you feel may have the required capabilities. Also, it may be possible for the treasury to have an informal conversation with its current relationship banks in order to understand if it can match the high-level requirements of the new project. During these discussions it is recommended that the treasury clearly states that it will be submitting an RFP to a number of banks and that this initial approach does not mean the bank will be able to secure the corporate's business without submitting a full response to the document.

The time and effort that is required to complete the first stage of the RFP process appropriately – and in enough detail – should not be underestimated. And of course, if the solution spans multiple geographies and/or business units then the time and resources required will be greater. However, completing the first stage correctly will pay dividends further down the line. If the treasury is able to fully understand its current processes and what it hopes to achieve then it will be able to convey this to the banks in the RFP and ultimately help them to suggest their best solutions.

## Drafting the RFP

How the RFP document is drafted will go a long way to ensuring that the banks are able to suggest the best solutions. It is vital from the treasurer's point of view to ensure that the RFP conveys precisely and clearly what is required according to the circumstances underlying the project. The document should be frank and open but omit irrelevant information. For example, explanations of company structure and other background details should be included only if it helps the banks understand what is needed from the solution.

To clearly convey what is required the treasury will need to go beyond asking basic questions. The questions set out in the

RFP have to be considered – and tested – carefully, to see if they are understandable, unambiguous, and likely to yield the type of answers that are sought after. In doing so, the treasury can avoid receiving 'cut and paste' answers and potentially irrelevant information. It is worth noting that unless the RFP conveys precisely what is required, the pricing is likely to be skewed; corporates should be aware that adding elements merely out of curiosity or as a demonstration of knowledge could push the cost up.

For some, the size of the RFP document is also a consideration. The logic is that a long RFP – over 50 pages – will potentially be overwhelming and off-putting to the banks. Because of this some argue that the bankers responding may not pay as much care and attention to every question as the treasury may wish them to. A document this length may also contain irrelevant information which, as stated earlier, should be omitted. Yet, there is another camp who argue that the size of the document is irrelevant: the belief being that the quality of (necessary) information contained in the RFP should not be compromised in order to keep the document concise.

Just as the questions need to be clear and precise, so does the layout – no matter the size of the document. It can be very useful if the RFP is broken down into manageable sections, both for the bank and the treasury team when analysing the responses. An introduction laying out the key requirements of the project (and perhaps a contents page for guidance) should be included to assist those responding. The banks should also be given sufficient space for their responses.

Concerning the responses, the RFP should instruct banks to what format they should reply in. This will give the best chance of the answers being in a consistent organisation from all the banks, making comparison easier at a later stage. Planning is required to do this efficiently – the instructions need to be prescriptive enough to allow comparisons, but not so restrictive as to stifle banks' creativity and style. In particular, it may be possible that a bank offers solutions which were not anticipated; space and flexibility may be required in order for them to express this. Moreover, banks pricing structures may vary, so if a corporate is too prescriptive in its demands a comparison may actually be made more difficult.

## Issuing the RFP

The response to an RFP will be lengthy – a minimum of 40 pages but maybe as many as 200. It is unsurprising, then, that when issuing an RFP it is often recommended to limit the number of banks invited to provide responses. Of course, the more invited to provide responses the more difficult it is to make a comparison but the bigger the list, the greater opportunity to find the most appropriate partner. This is a common conundrum for treasurers engaged in the RFP process.

It is however possible to build in mechanisms that do not limit the amount of RFPs that can be sent out, but does limit the amount of responses that are sent back. For example, the method described by Horan in the case study: including a list of key criteria at the start of the document that has to be matched, in order for the bank to be considered, is one such technique.

When issuing an RFP, the treasury should also include a timeframe for the banks to adhere to. This should be a

### Trevor Horan

Treasurer, Global Cash & Liquidity



*While some treasurers may simply see the RFP as a functional tool that allows the treasury to understand its different options and make an informed decision when implementing a new solution, Trevor Horan, Treasurer, Global Cash & Liquidity at Kerry Group, believes it can be more than this – and, in fact, that it can be an effective relationship management tool.*

For Horan, the key to achieving this is to make the RFP process open and transparent. The openness derives from ensuring that the tendering process is open to all banks (something which some may argue is ill-advised given the additional workload this creates for the treasury). For Horan, this is misguided. “I believe that all banks that the company has a strong relationship with should be offered the opportunity to win the business. By doing so, we demonstrate that we value their support and the relationship we have. We are also not limiting our options.”

Of course, like all treasurers, Horan does not want to have to sift through endless RFPs. So instead of not inviting banks to take part in the RFP process, Horan has built in a mechanism that reduces the amount of responses the treasury gets to its RFP. “At the start of the RFP document, just after the index, we include a list of key criteria that has to be matched,” he says. “If this criteria cannot be matched then we suggest that the rest of the document is not completed. This is where being transparent about the process prevents the banks from wasting time filling out the document and also reduces our workload when it comes to analysing the responses.”

We also make sure that those involved in the tendering process know who else has been invited, who has made the shortlist and who we are moving the process forward with,” he adds. “By doing this there are no secrets between us and our key counterparties, something that is appreciated by all involved.”

After the RFP process has been carried out each respondent is also given the opportunity of a full de-brief of their proposed solution in due course. “The feedback from banks to this de-brief has been extremely positive, it helps them understand why their solution was not selected and maintains strong relationships, something that is very important to Kerry Group,” says Horan.

realistic timeframe for the vendor to respond and with enough detail – this will vary depending on what the RFP is for and how many locations or business entities it covers.

### Making sense of the responses

Once the document has been drafted, issued and the responses have been collected, the next stage of the process is transforming the collected data into business intelligence. To do this each individual RFP should be reviewed in detail, hopefully giving a clear demonstration of each vendor's capacity to add value and differentiate itself and, in some cases, address issues that may not have been raised in the RFP.

The information that is provided by each bank will be different and will need to be placed on an even footing. Ideally, and depending on the size of the project, a well-crafted set of questions should enable the project team to consolidate answers on a single spreadsheet, allowing a quick view of scores for each aspect. To adequately score the responses, it is common practice to ‘weight’ each section according to its relative importance. This ensures that the overall score reflects those values, and that the outcome is not unduly influenced by an aspect that is of lesser importance. There are various methods of reaching a final score, but in any case the chosen model should be agreed upon before

starting to assess responses, to avoid any confusion or disagreement.

In the end, the decision may come down to which vendor the treasury team feels most in tune with or even price, but the RFP will have provided most of the technical information needed to be able to make the decision with confidence.

### Beyond the RFP

Once all the information has been collected and analysed, it is recommended that the treasury meets with its preferred choices to iron out any remaining creases. It is then up to the treasury to make its final decision. But even after this has been made, the usefulness of the RFP doesn't end. It can be retained as the basis upon which the implementation of the solution is measured and monitored. It can also be referred to should the bank fail to live up to its original promises.

At the end of the process, those involved will also want feedback – regardless of whether they won or lost the contract. Here, the RFP plays an important role in ensuring that the treasury communicates how it came to its conclusions. This review process is not just important for the banks, but also the treasury who can analyse what was done well (and what can be improved on), making for a smoother RFP process in future and one that is more likely to obtain the best services available. ■



INSIGHT AND ANALYSIS

What do corporates want from their banks?

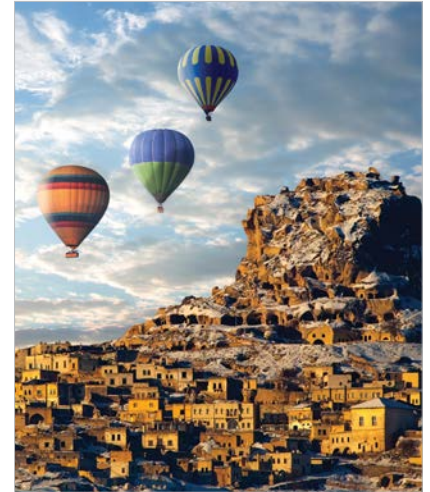
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CASH MANAGEMENT

Dynamic discounting

Dynamic discounting is a simple concept. In practice, however, there have been a number of barriers to widespread adoption. In this article we provide a refresher on what dynamic discounting actually is and the benefits that it can offer corporates and their supply chains.



RISK MANAGEMENT

Inflation hedging

The financial crisis of 2008 and the global recession that followed meant that inflation was not a top concern for corporates. However, as the global economic environment begins to slowly pick up, corporates may once again want to keep one eye again on inflation, and consider how best to hedge against it.

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

**Alawi Al-Shurafa**, Treasurer, Saudi Chevron Phillips & Affiliates; **David Blair**, Treasury Consultant, Singapore; **Daniel Blumen**, Partner, Treasury Alliance Group; **Brendon Bouwer**, Product Head of Liquidity Management & Account Services, Standard Bank; **Rando Bruns**, Head of Group Treasury, Merck; **James Buckle**, Director, Industrials; **Mark Buitenhek**, Global Head, ING Transaction Services; **Enrico Camerinelli**, Senior Analyst, EMEA, Aite Group; **Dennis Carey**, Solution Consultant, Reval; **Magnus Carlsson**, Manager of Treasury & Payments, the Association for Financial Professionals; **Robert Ceske**, Principal and Head of US treasury practice, KPMG; **Olga Cileckova**, Director, PwC; **Colin Cookson**, Managing Director of Liquidity, Aviva Investors; **Jon Dovener**, Head of Emerging Markets, Lloyds Bank Commercial Banking; **James Finch**, Head of Global Liquidity Management and EMEA Executive Director, UBS; **Andrew Gage**, Global Head of Research, FiREapps; **Lauren Goodwin**, Associate Practice Leader Global Analytics, Frontier Strategy Group; **Trevor Horan**, Treasurer, Global Cash & Liquidity; **Carsten Jaekel**, Finance & Treasury Management Partner, KPMG; **Jean-Claude Jossart**, Interim Treasurer; **Søren Kyhl**, Global Head of Transaction Banking, Danske Bank; **Ronald Leven**, FX pre-trade Strategist, Thomson Reuters; **Ian Lloyd**, Senior Business Manager for Liquidity, Legal and General Investment Management; **Yves Mersch**, member of the ECB's executive board and chair of the ERPB; **Andy Nash**, Senior Vice President and Group Treasurer, Ahold; **Dino Nicolaides**, Treasury Advisory Services Co-leader, Deloitte; **Jerry Norton**, Vice President Financial Services, CGI; **Virginie O'Shea**, Senior Analyst, Aite; **Dick Oskam**, Global Head of Sales, ING Transaction Services; **Karlien Porre**, Treasury Advisory Service Co-leader, Deloitte; **Pradeep Prakash**, Senior Manager Treasury, Majid Al Futtaim Holding LLC; **Kofi Erskine Aduku**, Senior Vice President, Group Treasury, Mubadala Development Company; **Chris Probert**, Managing Principal, Capco; **Bernd Richter**, Partner, Capco; **David Robinson**, Product Head of Payments and Collections, Standard Bank; **Thomas Stahr**, Interim Treasurer; **Murali Subramanian**, Executive Vice President, Abu Dhabi Commercial Bank; **Matthew Tatnell**, Head of Liquidity, Aviva Investors; **Erik Teiken**, Interim Treasurer; **Patrick Trozzo**, Vice President, Reval; **Sander van Tol**, Partner, Zanders; **Jan Vermeer**, Partner and Founder, Treasury Services; **Neil Vernon**, CTO, Gresham Computing; **Brian Welch**, Director, UserCare Treasury Consultancy; **Peter Wong**, Associate Director, Hong Kong/China, PwC Corporate Treasury Consulting.

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