March/April 2014

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Faster payments to the fore

Various initiatives are under way across the Asia Pacific region to improve payments infrastructures and enable real-time transactions. Will these schemes receive sufficient investment to realise their full potential and how will the introduction of faster payments impact corporate treasury functions?

The Corporate View

Chris Sutherland

Treasurer

Transpower

Corporate Finance

Is the BPO a solution looking for a problem rather than a genuine industry development or are corporates overlooking a significant opportunity? Treasury Today Asia investigates.

China Practice

The role of shadow banking

Risk Management

Tackling operational risk

Back to Basics

Hedge accounting

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A date for your diary

Women in Treasury

Whilst the treasury profession remains largely male-dominated, there are remarkable women enjoying remarkable careers in the treasury sphere, not least in the Asia Pacific region. At Treasury Today, we believe that it is important to recognise female innovators in the corporate treasury profession, which is why we founded the Women in Treasury (WiT) initiative. It aims to bring female treasury practitioners together to share their experiences, challenges, successes and failures, as an inspiration for all operating in this field.

Following the resounding success of the inaugural Women in Treasury Forum in London last October, the first **Women in Treasury Asia Forum** takes place on **Thursday 8th May 2014** at Raffles Hotel in Singapore. The Forum will commence at 12 noon with registration and a drinks reception, during which Angela Berry, Publisher of Treasury Today will present a summary of the key findings of our Women in Treasury Study. This will give you the opportunity to discover how female treasurers' job prospects and pay compare to those of their male counterparts – and what the impact of having a family is on a treasurer's career path.

We will then be holding a panel discussion moderated by Eleanor Hill, Editorial Director, Treasury Today Asia, followed by an open question and answer session. Areas of discussion will include the importance of making your voice heard within the organisation, as well as the role of mentors in promoting gender equality. This event will provide the rare chance for women in our industry to network, share their experiences and hear their peers discuss the key issues affecting their work within treasury.

A growing number of women are finding their voices and inspiring others to achieve progress – you can be one of them. If you are interested in attending the event, please contact our Head of Events, Lisa Bigley, lisa.bigley@treasurytoday.com, telephone: +44 (0)13 0462 9016.

In addition to the annual Women in Treasury Forum, we also run frequent Women in Treasury articles within Treasury Today Asia. If you would like to be profiled, or have a female treasury professional in mind that has inspired you in your career, please let us know by emailing editorial@treasurytoday.com.

Treasury Today Asia Woman of the Year

Remember that Treasury Today Asia will also be looking for inspirational stories from female treasurers for the forthcoming Adam Smith Awards Asia – turn to page 6 to find out more.

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in association with

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Shadow banking has played a key role in China's financial system for many years, but calls are growing for Beijing to curb its influence, before this informal lending harms the country's plans for sustainable economic growth. We look at whether it still has a positive role to play, and if Chinese regulators have the resources to police it.

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Neglecting to mitigate operational risks can be extremely costly – in both financial and reputational terms. Moreover, fraud, human error and environmental risks can all cause significant disruption to a business and its cash flows. We look at some of the biggest risks facing companies today and what treasurers can do to help manage the organisation's exposures.

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Treasurer

Chris Sutherland has overseen considerable change since taking the helm of the treasury at Transpower – the owner and operator of New Zealand's National Grid – including the integration of a new treasury management system, as well as a major capital restructuring. He speaks to Treasury Today Asia about how his experience in the banking and consultancy worlds has helped him manage the treasury of this state-owned company.

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Our Back to Basics feature in this edition focuses on a subject that can strike fear into the heart of even the most seasoned finance professional: hedge accounting. Here, a number of experts explain what hedge accounting is, the regulatory framework surrounding it and how it can reduce volatility on a company's profit and loss statement.

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

Moving on up: career tips for 2014

This year looks set to be a good one for treasury recruitment – with a number of openings for treasury professionals to progress in terms of responsibility, professional development and pay. Indeed, Mike Richards, Managing Director of treasury recruitment firm MR Recruitment, sees an improving landscape in 2014 across all levels of treasury experience and seniority. "Throughout 2013 there were a series of senior positions recruited," Richards says. "It is a rapidly improving picture for 2014."

So what can treasury professionals do to get ahead? Here are four tips from our expert commentators:

1. Diversify

It is advantageous to have a wider business background when looking to advance to senior treasury positions, believes Richards. For example, the majority of treasurers who have successfully made the transition to the CFO position have had wider experience in other areas of finance, not just treasury. While this may mean taking a lateral step outside of your comfort zone, it can give you the opportunity to learn new skills and can enhance your ability to obtain more senior/executive positions in the future.

2. Training and qualifications

According to Richards, training and qualifications are another step in the right direction, allowing candidates to develop their skills and learn new ones, while keeping up with the latest trends in treasury and business. Developing technical expertise is something that Paul Pomroy, Senior Vice President and UK Chief Financial Officer, North West Division Financial Controller for McDonald's, also sees as crucial in a treasurer's career path and he believes it is through training that you get the chance to do this.

Skanska Romania's Chief Financial Officer, Maciej Müldner, believes that, in addition to building up technical skills, training has a pivotal role to play in the development of a treasurer's soft skills. He sees these as key components for any treasurer looking to progress up the career ladder.

3. Stand out from the crowd

Being an excellent treasurer is one thing, but becoming a strategic business partner to the CFO and Board will help you stand out from the crowd. To achieve this, Pomroy suggests beginning to "develop a close relationship with all sides of the business and understand why the business is successful." Müldner agrees, saying: "you have to invite yourself into other areas of the business. Treasury can often seem detached from other lines of the business, so you have to bridge this gap."

4. Planning – with flexibility

Finally, having a long-term strategy in place can help you to decide where to take your career and how to achieve this. Having a plan should also ensure a logical progression up the career path, allowing you to continually learn and gain new experiences. Müldner has used a plan to shape his career: "my career path was a conscious decision," he says. "Maybe not the places I have worked at, but the roles I have selected. I knew what I was looking for."

Pomroy also believes a plan is important when looking to define your career, however he thinks that being ready to take advantage of opportunities that occur is even more vital. "You need aspirations of where you want to go, but more importantly you need to make yourself the most attractive candidate when the opportunity does arise." While there is a natural career path, "you don't know when the opportunity to take these roles will arise." Flexibility is key.

Farewell to trapped cash in China?

As a 2013 survey by EuroFinance revealed, China remains the country which treasury professionals perceive to be most problematic in terms of trapped cash. But with two global banks now offering two-way automated RMB cross-border pooling solutions within the SFTZ, that perception may soon need revising.

The solutions recently announced by Citi and HSBC offer further evidence of the progress made by Chinese authorities towards easing the cross-border flow of funds, helping multinational companies (MNCs) within the SFTZ to achieve strong liquidity management across the business.

Citi, who just announced the execution of the first automated RMB cross-border pooling transaction on behalf of Roche China, told Treasury Today Asia that having the ability to perform an automated two-way transaction is a significant step forward. Companies now have the ability, not only to automate the transfer of renminbi out of China, but also back to subsidiaries within the SFTZ.

"A lot of MNCs want to achieve two-way pooling," says Yigen Pei, China Country Head of Treasury and Trade Solutions at Citi. "On the one hand, they want a solution that can release their trapped cash overseas but on the other, an increasing number of

MNCs want the assurance of being able to use external group liquidity pools as a funding source for onshore subsidiaries," he added. "This type of pooling structure can address both of those concerns."

HSBC also recently announced it had completed a two-way cross-border sweeping service for industrial manufacturer Dover to help it deploy funds more efficiently between its onshore and offshore entities. According to Kee Joo Wong, Head of Global Payments and Cash Management for HSBC China, the development is consistent with the Chinese regulators' pledge to further relax foreign exchange restrictions as part of the FTZ pilot.

"This is in line with the expectations on how more innovative cash management techniques have been evolving in China, in line with international practice," says Wong. "These new and progressive advancements will clearly allow companies to move forward to access their liquidity in China – within a permitted framework – allowing for better utilisation both onshore and offshore," he added. "I trust that the perception of 'trapped cash' in China should, in time, change to a more positive note."

While this is undoubtedly good news for treasurers, the solutions offered by Citi and HSBC are, at present, limited to companies registered in the SFTZ. Although they allow a subsidiary in the SFTZ to receive funds from an offshore entity, under the current regulations companies cannot distribute the received funds to other entities in China outside of the zone.

But while this restriction somewhat limits the immediate utility of the reforms for corporates, the hope is that over the coming year reforms piloted in the zone will gradually be rolled out to the rest of mainland China. Once that point is reached, treasurers of MNCs in China will finally be able to execute inter-company cross-border sweeping in the same way that leading international markets allow.

India's corporates yearn for deeper bond markets

Over the past decade, India has emerged as one of the key markets in Asia. However, comparatively shallow capital markets continue to impede companies needing access to low-cost finance. It is an issue which has become particularly acute of late given the various macroeconomic difficulties the country's economy is now facing.

When compared with neighbouring economies within the Asia Pacific region, it is clear India lags some way behind in terms of the size of the corporate bond market. The corporate bond markets of Malaysia, South Korea, Thailand, Singapore and China each exceed that of India as a percentage of GDP, according to data from Asia Securities Industry and Financial Markets Association (ASIFMA). Of the major economies in the region, only Indonesia has a shallower market for fixed-income corporate debt, the figures reveal.

"In India, the government is a very big issuer, and that tends to crowd out a lot of private sector borrowing," Vijay Chander, Executive Director for Fixed Income at ASIFMA told Treasury Today Asia. But it is also a bit of a "chicken and egg" question, he goes on to explain. When an economy has an underdeveloped capital market, non-financial corporates tend to rely heavily on their banks for their financing requirements. Meanwhile, the banks must comply with a Statutory Liquidity Ratio (SLR) which compels them to "buy and hold" a large portion of Indian government bonds, which ultimately crowds out the corporate sector.

Building a better bond market

One source of comfort for corporates is that the Reserve Bank of India (RBI) recognises that there is a problem and has been reasonably proactive recently in attempting to address it. There are plans to introduce ten-year interest rate futures in order to address the concerns of market participants who could end up with illiquid bonds in the existing delivery based ten-year interest rate futures contract. "That will help," says Chander. "If banks can trade government bonds and not have to hold to maturity that should free up some capacity to lend to corporates."

There is a lot more work to do, however. There are signs of a market for high yield corporate debt beginning to develop and easing investment restrictions for pension funds and other institutional investors could help to broaden the investor base and improve liquidity in this nascent sector of the market. In addition, the investor base could also be widened by meeting the need for an international settlement and financing of local bonds. "To further integrate the Indian financial market within the international marketplace, CCPs such as the Clearing Corporation of India will have to be internationally recognised by the European Securities and Markets Authority (ESMA) in order to provide clearing services for all market participants," ASIFMA states. Chander therefore thinks that it is encouraging that India has applied for recognition by ESMA as any European domiciled bank will need approval from the body in order to trade on an Indian clearing platform. ■

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

treasurytoday
Adam Smith Awards
ASIA 2014

Recognising the best in corporate treasury

The Adam Smith Awards Asia recognise best practice and innovation in corporate treasury within the Asia Pacific region. Nominations will open on 16th June 2014 and there are 15 Award categories in total. If you believe your treasury team's work has gone above and beyond the call of duty, this is your chance to put yourself forward.

What's in a name?

Often heralded as the father of modern economics, Adam Smith is the perfect representative for Treasury Today Asia's corporate treasury Awards. His resounding influence can be felt today as much as at any other time in history, with his writings and analysis still providing a stable platform for the modern economic era.

These Awards are a celebration of those who, like Adam Smith, aim to push boundaries and think to the future. This might be a project to restructure the company's cash pooling arrangements, embrace eBAM, or raise finance in new markets. It's about recognising corporate treasury talent and innovation – regardless of budget, industry, or scale.

Why nominate?

Treasury Today has been successfully running an Adam Smith Awards programme globally for seven years now. These Awards are recognised as the pinnacle of best practice and innovation in corporate treasury and are an excellent way to demonstrate to senior management the value that treasury brings to the organisation.

In other words, the benefits of entering the Adam Smith Awards Asia extend far beyond collecting a prestigious trophy in November. Here are just three reasons why your organisation should be part of the action:

- √ Raise your treasury team's profile.
- √ Showcase innovation and thought leadership.
- √ Demonstrate excellence to your peers, partners, clients and investors.

How to enter

Nominations open on 16th June 2014. Everything you need, including the nomination form, can be found at **treasurytoday.com/asia/adamsmith**. It is a simple case of completing and submitting the short form online – which should take no more than 15 minutes of your time.

Any number of solutions can be entered for consideration. A single project can also be nominated in more than one category, where appropriate.

Nominations can be made by any corporate and banks and service providers can assist their clients in completing the nomination form. Banks and service providers are also allowed to submit nominations on behalf of their corporate clients (with the client's approval).

All winners will receive an invitation to the Adam Smith Awards Asia Lunch on 13th November at the Grand Hyatt hotel in Singapore.

Top submission tips

Above all, our panel of judges will be looking for solutions that showcase the industry's best and brightest and demonstrate exceptional best practice and innovation in the Asia corporate treasury arena.

There should be evidence of true effectiveness and of how you as a company benefited tangibly from the project. Have you implemented a solution that has delivered or leveraged any of the following for example?

- Outstanding cost savings.
- Above average ROI.
- Optimal account/treasury structure.
- Quantitative improvements in efficiency.
- Cutting-edge technology.
- Exceptional implementation (budget/time).
- Quality accreditation.

Testimonials, figures, and any supporting documentation can be included with submissions.

The Adam Smith Awards Asia are open to companies operating in Asia Pacific (regardless of their home base which can be within or without the region). The examples of best practice nominated should be deals and structures that have been implemented or are in the process of being implemented in 2013 and/or 2014.

Please don't be dissuaded from submitting a nomination in the event you feel your company may not qualify for whatever reason. You do not need to be a major multinational to qualify. Focus on the problem that the solution you have implemented, or are in the process of implementing, addresses. Quantify the benefits, both qualitative as well as quantitative.

Award categories

- Treasury Today Asia's Top Treasury Team 2014
- First Class Bank Relationship Management.
- Best Cash Management Solution.
- Best Short-Term Liquidity Investing Solution.
- Best Working Capital Management/Financial Supply Chain/AP/AR Solution.
- Best Card Solution.
- Best Financing Solution.
- Best Risk Management Solution.
- Best Process Re-engineering Solution.
- Best MME/SME Treasury Solution.
- One to Watch.
- Best in Class Benchmarking.
- Best Foreign Exchange Solution.
- Best Solution in China.
- Treasury Today Asia 'Woman of the Year'.

Should you have any queries please do not hesitate to contact us at **awardsasia2014@treasurytoday.com**

Bank account management

> *What factors are hindering greater uptake of BAM and eBAM technologies in Asia?*

Jarno Timmerman, Head of Treasury South East Asia Pacific, AkzoNobel:

Despite the technology to implement BAM and eBAM being readily available throughout Asia, the regulatory environment in many nations is a key factor hindering uptake. The regulators often still require you to produce physical paperwork and documentation which offsets many of the benefits that eBAM can offer, such as increased connectivity with banks and improved straight through processing (STP). Treasury departments in these countries will therefore be left with a two tier system – part completed through eBAM and part completed manually. The lack of efficiencies in this kind of solution make the integration cost harder to justify both in monetary and labour terms.

When implementing an eBAM solution, it is desirable for a treasury department to obtain 100% coverage over their bank accounts. This however is not possible in Asia due to the lack of support for eBAM solutions from regional banks. For example, many regional banks in Asia cannot support SWIFT connectivity and therefore if you have accounts with one or a number of these banks, only part of the standardisation and improved STP that eBAM brings will be achieved.

Treasury departments in Asia also often have greater priorities to deal with than eBAM. This, in part, explains its slower uptake in the region. For example, at AkzoNobel, we have previously prioritised the implementation of regional cash management structures and trade finance platforms over eBAM.

The implementation of eBAM is now on our agenda for 2014, however. A recent review of the company's cash management mandates globally means that this is a good time to begin implementing the technology. The project is being led out of our headquarters in the Netherlands. The South East Asia Pacific hub, based in Singapore, will provide a supportive role to the overall project, ensuring that the requirements specific to Asia are captured in the scope of the project.

The mature regulatory environment in Singapore means that we can avoid many of the issues eBAM faces throughout Asia and once implemented it will allow us to capture data from our transaction banking infrastructure with increased accuracy, and increased efficiency.

Therefore, while implementation of BAM and eBAM is slow in many Asian countries due to the regulatory challenges it poses, I do believe that in less hostile regulatory environments such as Singapore it will become increasingly popular as treasury departments mature and their priorities change.

Vairavan Ramanthan, Director, eCommerce and Channels, Asia Pacific, Bank of America Merrill Lynch:

Rationalising bank accounts and bank relationships is a major focus for treasurers across the region. With this trend of rationalisation poised to become more common in Asia Pacific, the question will inevitably turn to the adoption of automated bank account management (BAM).

While the interest is clearly there in Asia Pacific, there remains a diverse range of challenges hindering widespread adoption of BAM and electronic bank account management (eBAM). Currently, automated BAM is considered by treasurers as a value-add rather than a must-have. Significantly, 78% of respondents to our research have said they don't plan to implement automated BAM solutions.

There are reasons driving this behaviour. Firstly there is a lack of awareness within corporate treasury of the benefits of an automated BAM solution. The services and solutions provided by banks in this space are also holding back adoption. Ultimately, this lack of awareness makes internal account management teams resist a move to an automated BAM solution.

On the eBAM front, slower than expected adoption is largely a regulatory-based issue. Given the diversity of Asia Pacific and gaps in market sophistication, it should not come as a surprise that only three markets are fully ready for eBAM – Australia, Hong Kong and Singapore.

Regulations aside, widespread support of eBAM from regional and local banks is lukewarm at best, with global banks championing eBAM adoption. One of the major roadblocks is that corporate clients need to have two different processes – electronic interfaces with banks that support eBAM and manual interfaces with banks that do not support eBAM. This dichotomy makes it difficult to realise the full benefits of automated process using eBAM.

In our opinion, for eBAM to work, there has to be a widespread adoption of digital signatures, which is currently lacking due to the legal framework not favouring digital signature over wet signatures. Only Australia, Hong Kong and Singapore have passed legislation to support digital signatures.

In addition, many countries require an original or certified true copy which therefore makes the corporate duplicate the process by having to send electronic versions followed by physical copies. The promised automation of eBAM is not achieved in this case and the objective of digitalising the account management processes is lost.

There are other major considerations. For instance, adoption of multi-bank digital security and digital identification infrastructures like SWIFT 3Skey are not currently widespread. Furthermore, the integration of eBAM or BAM solutions to back office systems like Enterprise Resource Planning (ERP), Treasury Management Systems (TMS) and Human Resources systems (HR) is still a hurdle and the cost of integration is high.

For BAM and eBAM adoption to become more popular in Asia Pacific, awareness has to be created through customer education and broader support from in-country regulatory bodies. Corporates can start with the adoption of BAM by establishing a central data repository which supports account information, signer details, mandates and contracts. This will ensure a smoother migration to eBAM once the legal framework matures in Asia Pacific. Corporates, banks, SWIFT, technology vendors and consulting firms all have a part to play throughout this process.

Dan Gill, Senior Vice President, Weiland Corporate Solutions, Fiserv:

One of the major factors hindering greater use of BAM and eBAM in Asia is the slow uptake in the United States and Western Europe. BAM and eBAM are only just starting to make significant progress in these developed markets, where only a few steps need to be taken for corporates to implement the technology. Therefore in Asia, where it is often significantly harder to implement, the market is monitoring the progress of BAM and eBAM before taking any substantial steps. I predict once BAM and eBAM is widely used in the United States and Western Europe it will become increasingly popular in Asia as MNCs push the technology on their subsidiaries.

Regulatory issues are also proving a major stumbling block for the growth of BAM and eBAM in Asia. The strict rules surrounding banking in the region make it very difficult for a corporate to use eBAM. For example, it is sometimes the case that you need a physical presence at the bank to open or close an account and this is something that cannot be digitised. The uptake of eBAM in many Asian countries will depend on the evolution of the regulatory environment over time, to a point of being comfortable with electronic delivery of information.

Currently BAM and eBAM are primarily seen as efficiency tools. However the main benefit, for eBAM especially, derives from its ability to improve a company's controlling and audit processes. Matching a company's records to the bank's records is presently a challenge in all geographies. eBAM allows a company to accurately match and manage its bank account records, improving this process. Once the auditors begin to see this high level of accuracy consistently from companies who use eBAM it will become the de facto standard. Therefore if you are not communicating through eBAM it will be seen as a deficiency by the auditors and you will be penalised. Once this begins to happen, BAM and eBAM become more than efficiency tools and will become a must for treasury departments in Asia and worldwide.

The software that is required to utilise BAM and eBAM is already widely available in the Asia Pacific region and the global banks are attempting to drive the project forward. However, regional banks in the region are yet to put their weight behind BAM and eBAM and that will be required for it to fully take off. These banks will ultimately respond to demand, so corporates in the region who have an interest in using these technologies need to start putting pressure on their regional banks to support them.

In five years' time, I see BAM and eBAM becoming increasingly popular in Asia. Many major US and Western European companies will be using BAM and eBAM which will subsequently drive this further into the Asia Pacific region. In turn, this should trigger the banks to support the technology and help towards a maturing of the regulatory environment. ■

The next question:

"China's updated company law came into effect on 1st March 2014. What are the main changes that have been made and what do treasurers need to know about these amendments?"

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

Who needs faster payments?

A number of initiatives are under way across the Asia Pacific region to implement faster, or immediate, payment systems. Is local infrastructure really up-to-scratch though? Will the true benefits of these schemes be realised?

Mobile and online technologies have made rapid progress in the past decade as smartphones have become ubiquitous and broadband communications have been rolled out across the world. Businesses and consumers have come to expect rapid access to information and want to conduct transactions in real, or near real, time.

These developments have not been matched, however, in the payments space. The majority of financial institutions are burdened with ageing core banking systems and myriad regulatory demands are monopolising resources that might otherwise be diverted to upgrade programmes. The relatively slow clearing cycles in the payments world are coming under scrutiny as consumers and businesses demand more agile systems.

Across the Asia Pacific region, initiatives are under way to implement faster, or immediate, payment systems. Generally, faster payment schemes enable customers to make electronic payments almost instantaneously, seven days a week, 24 hours a day. The payments are typically made via a phone or internet-enabled device and involve the transfer of money between accounts, to other people, to pay bills or to make regular standing order payments. Some initiatives are based on, or have taken inspiration from, the UK's Faster Payments scheme, which was launched in May 2008 and by November 2013 had processed its three billionth payment.

Singapore

Singapore's Immediate Payments G3 scheme will be launched in mid-March 2014. The scheme supports credit transfers and direct debits. It focuses on two principal areas: real-time payments (RTP, low-value real-time gross settlement) and bulk payments (automated clearing house). RTP features include payer-to-beneficiary payment completion within five minutes (up to a maximum of SGD 10,000) and payment

completion within 15 seconds between participating banks, which are obliged to be able to receive and credit payments on a 24–hour-a-day, seven-day-a-week basis. The Singapore ACH for bulk payments has also been improved to provide support for additional details that will facilitate payment identification and invoice reconciliation.

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

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

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

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

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

India

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

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

Applications of IMPS include the purchase of goods from stores via users' mobile devices and online purchases via internet-enabled devices. IMPS offers multiple modes of funds transfers for mobile purchases, including a mobile application, SMS and a national, unified unstructured supplementary services data platform. Funds also can be transferred over the internet via accounts registered to IMPS or other accounts, using the Indian Financial System Code. The ATM network is also hosting IMPS payments, enabling funds to be transferred. Read more about the benefits of IMPS for corporates on page 32 of this issue, where David Blair, former vice-president treasury at Huawei, now Treasury Consultant at Acarate, gives his views on the progress being made.

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

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

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

Australia

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

Faster payments will be ushered in on the back of the New Payments Platform (NPP), a new infrastructure for Australia's low value payments. It will provide businesses and consumers with a fast, versatile, data-rich payments system for making their everyday payments.

An industry steering committee is overseeing development of the NPP. Chaired by Paul Lahiff, the New Payments Platform Steering Committee comprises senior representatives from the

Australian banking and mutual sector, an alternative payments provider and the Chief Executive of the Australian Payments Clearing Association, Chris Hamilton. The Steering Committee appointed KPMG as programme manager to the project.

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

The idea of the NPP is to provide an infrastructure that will support value-added services developed by individual financial institutions. The multi-layered infrastructure has been designed to promote competition and drive innovation in payment services. "Everyone will connect to the basic infrastructure and then individual financial institutions will be free to come up with products and services to offer their customers," says Lahiff. "As long as the integrity of the basic infrastructure remains intact, FIs can develop services that we hope will make for a more competitive, better payments environment."

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

Drivers and benefits

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

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

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

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

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

The ultimate success of faster payments schemes will possibly reside with financial institutions; as with the Australian scheme, it will be up to the banks and other organisations to develop new and innovative products and services to complement the faster payments. However, many banks are burdened with ageing core banking systems and upgrading these is costly. The development of faster payments in the UK was a slow burn, with banks rolling out the scheme very slowly and to little fanfare.

A similar scenario is playing out in Singapore, where the MAS has kept fairly quiet about the G3 project, wanting to ensure the platform is stable before promoting it widely. Many banks in Singapore are adopting a wait-and-see approach, enabling the trailblazers to test the market first. It is possible that some banks may see more rapid payments as a differentiator for corporate banking services.

By enabling Singapore's banks and financial institutions to process low value payments in real time, innovative and commercially attractive banking products could be developed to counteract the threat of new market entrants, while minimising settlement risk and offering customers the surety and guarantees of a bank-based payment. By moving money at a higher velocity, the MAS hopes the economy and Singapore's business community will benefit, keeping Singapore at the forefront of regional payments and setting the benchmark for innovation.

The future of faster payments

Proponents of faster payments say schemes can provide a platform for value-added services, improving the efficiency of payments systems and ultimately bringing down costs. Faster payments initiatives are not short-term money making ventures, as has been proved in the UK where it has taken around five years for the market to gain momentum.

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

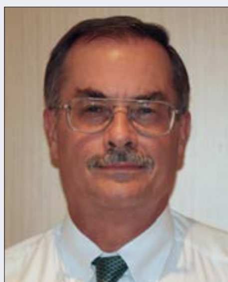
Many countries around the world are investigating instant payment schemes. The US Federal Reserve Board is encouraging US banks to introduce faster retail payments as part of a wider effort to modernise the country's payments infrastructure. As more and more countries look to upgrade their ageing payments infrastructures, faster payments will inevitably become ubiquitous – it just may take more time than proponents would wish. ■

Managing currency volatility in emerging markets

Currency volatility across the emerging markets was one of the top risk stories of 2013. Just the slightest hint of the US Federal Reserve unwinding its quantitative easing programme sent a number of emerging market currencies into free fall. Corporate treasurers are therefore fully aware of the need to manage the risk caused by currency fluctuations today and in the future.

Phil Weisberg
Managing Director and Global Head of Foreign Exchange, Thomson Reuters

Eric Burroughs
Editor FX Buzz, Reuters News



Damian Glendinning
Corporate Treasurer, Lenovo

Last month Thomson Reuters, in partnership with Treasury Today, hosted a webinar 'Managing Currency Volatility in Emerging Markets' exploring the key factors influencing the recent volatility in emerging markets currencies.

Eric Burroughs, Editor FX Buzz, Reuters News, set the scene by discussing the emerging markets vulnerabilities as exposed by the spike in US yields. He also referred to the 'fragile five' (a term coined by Morgan Stanley when referring to the currencies of South Africa, Turkey, India, Indonesia and Brazil) highlighting that the currencies of Turkey and Indonesia are particularly problematic and should receive special attention from corporates in 2014. The difficulties seen in India and Indonesia during 2013 also highlighted the severe implications of FX volatility on liquidity. Regulatory pressures in emerging markets, specifically where they are proving difficult in non-deliverable forwards (NDFs) for hedges must also be closely monitored by corporates.

The challenges for corporate treasurers, according to Phil Weisberg, MD and Global Head of Foreign Exchange at Thomson Reuters, is to navigate what is less and less an homogenous asset class. The continued movement away from an environment that was essentially determined by risk appetite to one that is increasingly being driven by the fundamentals and individual stories within each country is not an easy task for corporates to manage. Weisberg suggested that corporates can make strategy decisions that are currency-specific rather than treating these markets like an asset class.

Weisberg saw three major themes for the currency markets:

- **Firstly**, the emerging markets we have been talking about for years have now emerged and their currencies trade similarly to other more mature currencies. He highlighted the Mexican peso (MXN) and Chinese renminbi (CNY) as prime examples.
- **The second** theme Weisberg discussed was regulation. He noted that while the driving principles of new regulations were transparency, reduced risk and increased customer protection, there have been some technical challenges to the liquidity function in adjusting to the changes. He also explained that while some market participants, particularly those in Asia, have taken a 'wait and see' attitude towards regulatory requirements, it is important to realise that the rules will soon start impacting everyone in the market, as in the case of reporting trades to swap data repositories.

- **The final** theme Weisberg highlighted was the risk management process and practices, such as electronic trading and planning ahead, that corporate treasurers can use to mitigate such risks.

> "The challenge for practitioners is to learn how to navigate the regulatory changes".

For his part, Corporate Treasurer at Lenovo, Damian Glendinning, said "the challenge for practitioners is to learn how to navigate the regulatory changes – a challenge that is complicated by the fact that the changes to come have not yet been clarified".

In hedging currencies, Glendinning recommended treating emerging markets the same as mature markets and stressed that volatility is not necessarily linked to emerging market status. He offered some sound advice to corporate treasurers in suggesting that a clear hedging policy and approach is fundamental for all currencies, not just emerging market currencies. The difference with emerging markets is that they often have exchange controls, which can have an impact on the ability to hedge and lead to increased use of NDFs. It is here that regulations come in and the importance of planning ahead is again necessary.

> "Exchange controls ... can have an impact on the ability to hedge and lead to increased use of NDFs".

A clear policy of currency risk and hedging should be an essential component of every corporate treasury policy. Percentages of transactions to hedge must be determined, the cost of hedging versus the risk should be evaluated and management should be made aware of the trade-offs.

Some currencies are expensive to hedge or cannot be hedged such as the Venezuelan bolivar and Argentine peso. Glendinning suggested that corporate treasurers explore local borrowing or factoring as a means of expediting settlement. Local manufacturing opportunities could also be used to create offsetting exposures, reducing the need for hedging in the first place.

Glendinning stressed that corporate treasurers and management must understand their business models and evaluate the level of risk they are willing to take. It's important to evaluate cost of hedging vs risk. In their closing remarks, the panellists agreed that corporate treasurers should not wait for the regulations to be crystallised to prepare and craft clear policies and approaches for managing currency volatility in 2014.

The webinar is available to view in full at: **treasurytoday.com/webinar**

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Thailand: bouncing back

In recent years, Thailand has undergone major financial sector reform. In the face of labour shortages, natural disaster, political unrest and protective foreign exchange controls, the country has still pushed forward within the ASEAN community, working towards integration with the region's capital markets. Treasury Today Asia asks what is driving Thailand's economy, where is it headed and, more importantly, what does all this mean for corporates operating in and out of the country?

Dubbed the East Asian miracle in the early 1990s, due to its substantial economic growth, Thailand was considered one of the success stories of the region. During this period, the economy took great strides from its humble agricultural background as Thai society relocated to work in the newly developed industry and service sectors. In the late 1990s, however, cracks began to appear in the economy as the Asian financial crisis hit. This resulted in the virtual collapse of the Thai economy, brought on in part by the very policies that facilitated Thailand's growth.

Current economy

Since the 1997 financial crisis, Thailand has undergone a transformation and now boasts a pro-investment, free-enterprise economy built on a solid infrastructure. Driven by a strong export market, which in 2012 accounted for 75% of its GDP, the Thai economy has recovered well. Manufacturing and agriculture provide the bulk of Thai exports, with the nation's key trading partners including Japan, China, the United States and Malaysia.

Nevertheless, over the past year there has been a slowdown, which saw the Thai economy enter a recession in the first half of 2013. This was due in large part to tough global economic conditions which led to a decline in demand. Although this trend reversed in the second half of 2013, with increased demand leading to positive growth – and further growth is predicted to continue in 2014 by the Bank of Thailand (BoT) – Thailand's economy remains heavily reliant on exports, which may pose a challenge to sustainable long-term growth.

An additional challenge facing the Thai economy is political instability – which has blighted the country since a military coup in 2006. Tensions reached the fore during the country's political crisis of 2008-2010 and both consumer and investor confidence were badly affected. Political tensions surged again in 2013 and have spilled over into 2014, with mass demonstrations and protests on the streets of Bangkok. Jim Foley, Managing Director, Citi Treasury and Trade Solutions, Thailand, believes that "the current wave of political uncertainty again poses a danger because it affects the confidence of both local Thai corporates and offshore investors." The overriding concern is that a continuation of political instability may ultimately deter potential investors and existing businesses may relocate.

Elsewhere, a report by The Economist Intelligence Unit points out that the "shortage of labour – both skilled and unskilled – has been a chronic issue for businesses in Thailand".

Key facts:

Land area: 510,890 sq. km*
Population: 67,448,120* (July 2013)
GDP (2012): $336.0 billion**
Labour Force: 39.41 million*
Gross National Savings: 30.4% of GDP*

**CIA World Fact Book*
***World Bank*

Despite a low unemployment rate, the report highlights the onset of an ageing population as a key reason for this shortage. Foley recognises this is a challenge, however is keen to put forward a more tempered view: "it is not at a point of crisis," he says. "Companies can still get workers, but it is becoming more of an issue." A solution to this may come with the further integration of the ASEAN region and the free flow of labour into Thailand. That said, Foley warns that "this could heighten the problem if members of the workforce choose to leave Thailand for other ASEAN destinations."

Environmental risk is another challenge that faces corporates operating in Thailand as demonstrated by the floods of 2011. The economic loss caused by the disaster was vast: the World Bank reported it to be $45.7 billion between July and December 2011, with the biggest hit being taken in the manufacturing industry. Since the event the Thai government has invested in water management and flood preparation projects as a means to alleviate the issue, however, in 2013, 17 factories again had to be closed in the industrial zone due to flooding.

Financial sector reform

A review of the Thai financial sector following the 1997 crisis concluded that it was weak and poorly regulated, and that this had assisted in deepening the crisis. The Thai government has since moved to resolve this issue, launching a three-phase final sector master plan (FSMP) with the aim of making the sector more efficient, competitive and transparent. Here follows a brief outline of each phase:

Phase I

Designed to overhaul the commercial banking licence system, phase I was completed in 2009 replacing the legacy system with a streamlined four licence structure. As a result of the changes a number of institutions surrendered their licence, having to either

ASEAN overview

Thailand is the second largest economy in the Association of South East Asian Nations (ASEAN) and is on course to become a key part of the ASEAN Economic Community (AEC). Looking ahead it is likely that the further integration of the region will prove increasingly important for corporates operating in Thailand. For example, The 2014 American Chamber of Commerce ASEAN Business Outlook Survey stated 70% of companies operating in Thailand see ASEAN integration as helping their company do business in the region. A further 73% said that ASEAN will become more important to their companies' worldwide revenues over the next two years.

A 2013 Study by the Economist Corporate Network cites economic growth rates, the size and spending power of the consumer population and the growing presence of business customers in the region, as the most attractive points of ASEAN integration. Furthermore, ASEAN will benefit more than just foreign MNC's looking to invest in the region, many local Thai companies are keen to take advantage of the integration as they believe they have reached their growth limit in the domestic market.

reapply or merge with another bank in order to re-obtain a licence. The reforms have led to "the significant consolidation of the Thai banking sector," says Foley. To illustrate this, 83 financial institutions operated in Thailand in 2003, which by 2010 was reduced to just 38. "The reforms have made the banks stronger," says Foley, "and can now benefit larger corporates by offering more operations and greater branch coverage."

Phase II

Designed to build on the improvements made during phase I, phase II has looked to reduce system-wide operating costs while increasing competition and allowing for greater financial access. New providers have been permitted to enter the market and current banks have been allowed to expand their services. Investment is also being made in the technological infrastructure and in risk management which aims to further strengthen the sector.

Phase III

Scheduled to begin in the next few years, phase III will evaluate the results of phase II and build recommendations based on this.

Although the process is still ongoing, the FSMP has already achieved a number of its objectives including improving the infrastructure of the financial sector. Since 2010, Moody's has declared the system stable, stating that "Thai banks are well positioned to withstand potential asset-quality challenges because of their strong capitalisation levels and increasing provisioning coverage." "Thailand now has an efficient financial system," agrees K. Wanida, Vice President Finance at PTT Group, "with good risk management and corporate governance, which is strong and not burdensome for the country and supportive of economic development in both normal and crisis scenarios."

The strengthening of the financial sector has improved the operating environment for corporates in Thailand. Local banks now have an extensive branch network, which is important for day-to-day processes and "their increasing strength has allowed companies in Thailand to grow locally and offshore like never before," says Foley.

The entrance of foreign banks into the Thai market has also given corporates greater choice in terms of relationship, solutions and technologies. Thai energy company PTT now uses both international and local banks depending on the services required. "Companies operating in Thailand now have a greater access to diversified financial services appropriate to demand," says PTT's Wanida. "There has also been a reduction in the costs of financial services."

The single lending limit employed by the BoT, which caps commercial banks' lending to 25% of their risk capital, still remains an issue for companies who require large amounts of funding, however. The PTT Group for example, which has 300 firms operating under its umbrella which require large capital investment each year has faced issues regarding this. To solve this issue, in 2013 PTT set up an in-house bank to secure financing. The in-house bank, which is located in Singapore, due to its greater regulatory flexibility, will not only solve this issue but also benefit in terms of financial costs and returns on investments.

Trapped cash

Like many countries in South East Asia, Thailand has capital controls regulating the inflow and outflow of investment in the country. The nature of these controls makes trapped cash an issue for corporates operating in the country. This was highlighted in a recent EuroFinance Corporate Treasury Network Survey where Thailand was ranked sixth globally, and first in South East Asia, among geographies where trapped cash is a concern.

"The primary reason for this," says Gourang Shah, Managing Director, Citi Treasury and Trade Solutions, Singapore "is that corporates are unable to freely carry out cross-border inter-company lending in Thailand. Treasurers are therefore unable to include Thailand as part of their global cash pooling structure, making it difficult to move funds in and out of the country on a daily basis."

Inter-company lending is not the only issue regarding trapped cash in Thailand. "Corporates need a large amount of documentation, which can include approval from the BoT before they can remove any significant amount of cash out of the country," says Foley. "For example, any payment over $50,000 in and out of Thailand needs not only full documentation surrounding the payment but also a physical affidavit signed by the company." Furthermore, profits made offshore have to be repatriated within 360 days.

Over the past year, a number of Asian nations have begun to relax their capital controls relieving the issue of trapped cash. "Thailand is lagging behind the pack on this front," says Shah, "and unlike some of the other markets, Thailand has not yet been fully opened up and special approval is still needed to move funds out of Thailand."

"The problem for Thailand," explains Foley, "is that the majority of these measures were brought into law due to the 1997 crisis and although the BoT wants to change these and bring in new investors, it requires an act of parliament, which slows the process."

Escaping the cash trap in Thailand is therefore a difficult job for any corporate operating in the country. There are,

however, some simple steps that can be taken to assist. "Ensure open dialogue with your bank, legal/accountancy advisors and potentially the BoT and be transparent about your proposed operations," advises Foley. "If you are a newcomer to the market, start these conversations very early and ensure that you create a structure which will allow you to release your money easily in the future."

"Paying dividends more frequently is another way to alleviate some of the trapped cash issues in Thailand," advises Shah. "Although this may not be something a company wishes to do regularly it is becoming an increasingly popular method of escaping the cash trap."

Corporate treasury in Thailand

Large multinational companies that operate in Thailand generally employ a similar structure to those in other markets. They typically operate from a regional treasury centre which is based outside of Thailand, in countries such as Singapore or Hong Kong. "Thailand currently doesn't offer the right incentives for corporate treasurers," says Shah. The capital controls on cross-border inter-company lending and the limited liquidity in foreign currencies locally inhibit corporates to operate their regional treasury out of Thailand. I therefore don't foresee Thailand becoming a big treasury centre for multinationals in the near future."

Broadly speaking, local Thai companies base their treasury operations inside the country and manage operations from there. However large Thai companies are increasingly looking to move their treasury operations outside the country. "The capital controls and regulations in Thailand are driving this trend," says Shah. "The move to an open market will allow companies to create and utilise a global cash concentration centre, which they would find challenging to do in Thailand."

"This however isn't for everybody," he adds. "What is being discussed is how Thailand can become a viable cash concentration and treasury centre itself." Thailand currently employs a withholding tax of 10% on dividends paid to non-residents and 15% on royalties and interest paid to non-residents which Shah believes is "one of the big deterrents to establishing a global cash centre in Thailand and is something which needs to be reviewed by local regulators."

Payment methods and settlement systems

Paper is still king when it comes to business-to-consumer and business-to-business payments in Thailand. Although electronic payments are becoming increasingly popular in the country, there are still challenges. For instance, "you have to give beneficiary advice separately – the clearing systems for GIRO or ACH have no facility for exchange of name or reference details," says Foley. In other words, the infrastructure for paperless payments exists – it just hasn't been properly turned on yet.

"It still takes two days to get value across electronically, bank-to-bank," continues Foley. "Because of this, many companies have an account with the majority of banks in Thailand. Customers are therefore able to make payments into an account of the same bank and sweep the funds from there."

Bank of Thailand automated high value transfer network (BAHTNET)

BAHTNET is Thailand's real-time gross settlement system (RTGS) for transferring high value amounts. Established by the BoT in 1995 the system is designed to reduce cost and systematic risk. Operated using SWIFT or the BoT's own web portal, BAHTNET allows both domestic and cross-border payments. By design, high levels of liquidity are needed to operate the system. "It is reasonably expensive to use," advises Foley, "but it does work and is part of the core payment infrastructure."

Imaged cheque clearing and archiving system (ICAS)

The Thai government has recently revamped the country's cheque payment and clearing system. Replacing the legacy cheque clearing system ICAS is a centralised cheque clearing system implemented nationwide in 2013. The system was built to shorten the cheque clearing cycle to one day nationwide and to enhance the efficacy of the process overall and meet international standards. "This is a fantastic system," says Foley, "however they have not yet changed the legacy environment of having 71 clearing zones. This means that for any payments issued outside of the same clearing zone there is a 0.1% charge on the face value of the cheque presented."

Bulk payment system

Operated by the national transaction management and exchange (NITMX), the bulk payment system allows for preauthorised inter-bank transactions that are large in volume and have a recurring payment period, such as wage payments. Membership of the NITMX is not restricted to local banks, allowing foreign banks, who are often preferred by large multinationals operating in Thailand, to gain a large share of the payments market, despite the restrictions they operate under.

Payment systems roadmap 2012-2016

A payments systems roadmap for 2012-2016 was created by the BoT following an evaluation of the strengths and weaknesses of the Thai payment systems alongside a comparative study of other countries' systems to establish a framework for future development. Its vision is to ensure that Thailand provides payment mechanisms which facilitate efficient, stable and safe economic activities in both the public and private sphere domestically and internationally.

Comprised of three key objectives, the roadmap seeks to enhance the efficiency of the Thai payment systems, firstly seeks through development and promotion of access to the electronic payment systems to ensure that these are prepared for the integration of the AEC. Secondly, the roadmap seeks to reduce the risk associated with foreign exchange settlements and when using BAHTNET. Finally there will be a focus on increased consumer protection and the overall building up of confidence in the payment systems.

In October 2013, as part of the roadmap, ISO20022, the most advanced financial messaging standard, was adopted allowing for faster payments and better cash visibility for corporates in Thailand. Last year also saw a cross-border payment versus payment (PvP) link between BAHTNET and Hong Kong's US dollar real-time gross settlement system announced. Set to launch in 2014, the link will allow for reduced risk in foreign exchange transactions and promotes safer and more efficient payment flows. Furthermore, Thailand is also monitoring global trends and is preparing its payment system to handle the use of the renminbi for international trade in the future. ■

RMB investments in China

An everyday phenomenon

New approaches to cash management and investments in China must be sought if corporate treasurers are to leverage the progressive liberalisation of the remninbi (RMB)

Not a day goes by without another statistic published that points to China's fast ascent to global significance in international trade and, in turn, to global economics. But the opportunity only started to become a reality once China had embarked on its steady but relentless journey of financial liberalisation a few years ago.

Throughout 2012 and 2013 a number of key regulatory changes were unleashed as the People's Bank of China (PBOC) or central bank drove further RMB internationalisation. A simplified cross-border settlement process, further exchange and interest rate liberalisation by widening the RMB FX trading range and removal of loan interest rate controls are a reality. The State Administration of Foreign Exchange (SAFE) too has been transforming administrative controls that will lead to greater consistency and transparency via a number of reforms to current account and capital account rules.

As China's relevance and importance to international companies has increased, so the RMB has risen in importance for trade settlement. According to SWIFT, in October 2013 RMB was the world's second most-used trade finance currency (some way behind the US dollar but significant nonetheless). It remains the 12th largest currency for payments globally (compared to 35th three years ago).

As the market has opened up, more companies have started to hold and utilise RMB cash balances – both onshore and offshore – for payments and receipts. The reasons for this are clear; doing so can improve FX risk management, potentially reduce costs, better align the company to its Chinese customers or suppliers payment preferences and, in turn, provide incentives for better trade terms.

Total RMB deposits onshore in mainland China stand at RMB103 trillion and in Hong Kong (the largest offshore market) stand at RMB826 billion (both as at November 2013), a little over 11% of total deposits across all currencies in Hong Kong[1].

The evolution and expansion of cash management techniques

The development of China's financial and commercial infrastructure adds tools and flexibility to enhance corporate working capital and cash management practices both in China and offshore operations. With the gradual relaxation on capital and currency controls, China is encouragong international companies to set up business operations and treasury centres onshore. Many of these enhancements have been managed through pilot schemes launched through a limited group of companies and banks.

Until recently, corporate cash and liquidity management in China has been largely domestic, in terms of the payments system and tools, liquidity management structures (such as domestic cash concentration) and how treasury functions operate. These practices and tools have evolved considerably over the past two years in terms of enhancements to domestic and to cross-border and offshore cash management.

The most significant developments include:

- **Cross-border trade settlement:** schemes to streamline cross-border payments and receivables processing using netting and gross-in/gross-out settlement methods in pay-on-behalf/receive-on-behalf (POBO/ROBO) models; reduction of documentary requirements; and using technology to streamline manual processes. End-to-end electronic payment processing has been piloted, allowing electronic submission of supporting documentation. These schemes will allow payments into/out of China to be processed more efficiently, promptly and with greater control, visibility and centralisation.
- **Cross-border liquidity optimisation:** pilot initiatives are being rolled out to support cross-border sweeping and intra-group cross-border lending. These allow treasurers to manage surplus cash in China more efficiently, with internal funding optimisation achieved through linking onshore positions with their international treasury structures.

Options for the investment of surplus RMB

With the expansion of cash and liquidity management tools, and the increase in RMB currency balances held, treasurers naturally focus on how short-term balances are managed and invested within their usual risk management framework and investment policies. A number of options exist in various offshore markets such as London and Hong Kong, but what about RMB balances that remain in mainland China?

Deposit options in China

RMB deposits sitting in bank accounts in China currently provide a return largely determined by existing central bank regulations which provide a baseline rate commonly known as the PBOC deposit rate. See boxed example.

A further option (typically for longer-term cash) is structured deposits. These are arranged with additional terms, usually incorporating a derivative transaction allowing investors to hedge against movements in interest rates or FX. Tenors vary.

[1]Source: PBOC, HKMA, HSBC Global Asset Management.

RMB deposit type	PBOC deposit % return per annum*
Normal RMB deposit	0.35
Contract savings	1.15
One day call deposit	0.80
Seven day call deposit	1.35
Three month time deposit	2.60
Six month time deposit	2.80
12 month time deposit	3.00

**New regulatory changes in China introduced in 2013 allow for the above rates to be adjusted upwards to a max of 110% of the PBOC rate, at the discretion of the respective bank.*

Source: PBOC, as at end December 2013.

There has been commentary on liquidity levels in the China banking sector recently, with volatility in interbank rates in China towards the end of 2013; for example the seven-day repo rate increasing from 4.5% to 8.5% during December. The central bank has however provided liquidity since then as part of its normal operations and rates fell in January.

Onshore RMB liquidity management

The regulatory framework in China currently does not permit inter-company lending. The only way companies can lend to one another is under the 'entrusted loan' framework used by banks in China to help companies structure their cash pooling solutions. Apart from using bank deposits to generate a return, companies with excess RMB liquidity in China continue to explore onshore RMB liquidity management structures (such as RMB cash concentration/pooling) to optimise their onshore RMB working capital amongst group entities and as a means of reducing external bank borrowing needs onshore.

RMB cross-border lending

Companies are now permitted to lend their excess RMB liquidity in China to related companies offshore. A transfer-pricing mechanism ensures transactions are maintained at arms-length. This option offers the opportunity to mobilise RMB excess liquidity internationally to be utilised as an internal source of funding, reduce external indebtedness or participate in centralised investment programmes. Some companies might not find this model optimal in the absence of ways to redeploy liquidity more efficiently, and considering RMB deposit rates and returns in China remain attractive.

Money market funds

An onshore legal entity in China can also invest in an onshore RMB money market fund (MMF). The industry in China is just over ten years old, with assets under management of RMB883 billion (c. $146 billion) at the end of December 2013[2]. There are over 100 MMFs in the country, falling into two categories; funds provided by international asset managers (and managed similarly to those offered in Europe and the US), and funds offered by local Chinese asset managers who follow the risk profile set out in local domestic regulation.

MMFs in China can offer investors a valuable complement to existing bank structured deposits or reverse repo transactions. They invest in a basket of short-term money market instruments targeting a liquid or low-duration portfolio, offering next-day liquidity. The range of issuers and asset types in China is lower than money markets in the US and Europe. However, a typical fund offered by an international manager includes investments in Chinese government bonds, Central Bank notes, PBOC bills, repurchase agreements backed by Chinese sovereign debt, deposits and other investments from the three agency banks that are 100% owned by the Chinese government, as well as deposits and other investments issued by the "big four" banks.

MMFs in China can provide a higher net-return compared to short-term bank deposits – by way of illustration, and for comparison to the deposit table above, the average net returns for the month of December 2013 of all AAA-rated RMB MMFs was 4.339% per annum[3] (there are currently five RMB MMFs that hold the local AAA rating in China). There are two reasons why this can be the case; firstly, dividend income from a MMF is free from corporate income tax in China (compared to a 25% income tax on bank deposits); secondly, the interest paid on bank deposits in China is regulated, whereas the majority of investments placed by a MMF are not, and are therefore driven by the market and so returns can potentially be higher or lower.

What next for RMB and China?

As financial liberalisation continues and accelerates, it will become easier to do business in China. As more schemes are rolled out, and existing pilots are broadened, corporate treasurers should look to create greater efficiency and control over their RMB and foreign currency transactions and balances. Confidence remains that the RMB will become fully convertible in the next five years and, as markets deepen, greater choice for investment options are expected, including for offshore RMB investment options in the future.

Given the pace and complexity of change, it is important to stay informed and to work with the right banks and asset managers. These should not only understand the local market and be actively involved in new schemes as they are piloted and rolled out, but also have international reach to provide a consistent service globally, enabling companies to connect their cash management across the markets and currencies in which they deal.

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HSBC Global Asset Management

[2]*Source: HSBC Global Asset Management.*
[3]*Source: HSBC Global Asset Management.*

BPO: a solution looking for a problem?

Some experts believe that the arrival of the bank payment obligation (BPO) marks the biggest change in international trade settlement in over 30 years. But what exactly is the BPO and what does it have to offer for corporate treasurers?

Sometimes new processes can take a while to become fully established. SWIFT's BPO is a case in point. The first end-to-end automated trade finance transaction using the BPO was carried out, with the help of Standard Chartered, between Belgium-based BP Aromatics and Oman-based Octal Petrochemicals as far back as 2011. But since then, uptake has been gradual at best.

There are good reasons to believe this will change in the next 12 months, however. Last year, a milestone was reached when the International Chamber of Commerce (ICC) published uniform rules and technological standards for the BPO, giving users of the solution the legal clarity they previously complained was lacking. Over the past year, SWIFT has also invested considerable time and resources in an educational campaign to communicate the benefits of the BPO to corporates, banks and other important stakeholders.

On the banking side, at least, the campaign appears to be paying off. According to the latest data from SWIFT, a total of 12 banking groups are now ready to go live with the solution, with a further 56 – including 15 of the top 20 trade banks – currently in the process of adopting the BPO.

The opportunity for banks

One reason why BPO uptake has been slow thus far may be the threat some bankers perceive the solution poses to the letter of credit (LC) – a revenue stream for banks which they are naturally keen to retain. But Jim Bidwell, Global Head of Documentary Trade Product Management at Barclays, believes these fears are misplaced. At Sibos, SWIFT's four-day user conference hosted last year in Dubai, he attempted to set the record straight. Although banks will inevitably see some business move from the LC to the BPO, the migration will only be partial and will certainly not eliminate demand for LCs entirely, he told assembled delegates at a breakfast briefing hosted by Barclays.

Indeed, what the banks might lose in LC business, over time, is likely to be far less significant than what they are poised to gain from being able, with the BPO, to re-intermediate themselves through financing in the Open Account space. "For banks that think deeply about the BPO, commit to it, and put their propositions together, I think the opportunities in Open Account far outweigh that which might be lost on the small part of the LC business," says Bidwell.

Uncertainty about how the BPO would be used in practise has also hampered uptake, according to Bidwell. All the while that the BPO was an initiative exclusive to SWIFT it was always going to be very difficult to reach critical mass in terms of bank adoption. But there is hope that the ICC's rules, by bringing the BPO in line with other trade finance products such as the LC, documentary collections (D/Cs), and guarantees, will now facilitate an increase in bank confidence in the technology. "Now the banks have a clear set of standards to work with," he explains, "which means that banks don't need to have separate agreements with SWIFT and other parties, as everyone knows the rules to play by. That was a very important step."

Moving forward, Bidwell would like to see greater collaboration between banks. This, he notes, is absolutely imperative if the BPO is to be a success. To explain, Bidwell uses an example of a financing opportunity involving a supplier based in an unfamiliar market. "If Barclays were the obligor bank in a transaction, we would find it very difficult to provide pre-shipment finance to a supplier in a country such as Taiwan, for instance, where we do not operate. But what we could do to help our client finance their supply chain is to work with a local Taiwan-based bank and encourage them to use the BPO to provide pre-shipment finance for the supplier, based on the fact that Barclays is guaranteeing the payment risk in its role as obligor bank."

Fortunately, the BPO's design supports interoperability between participating banks, making the collaboration Bidwell speaks of relatively straightforward. This interoperability is made possible through the use of a standard set of ISO 20022 messages, each of which reflects events that have taken place in the physical supply chain, and, according to SWIFT, "creates trigger points for the provision of financial services".

Building a business case

In terms of adoption, another argument the banks are often heard making is that they want to see corporate demand become more established before they go live with the BPO. So far, only a small number of corporates have experience of using the solution (mostly commodity players such as OCTAL Petrochemicals) but the feedback from that sample has nevertheless been largely positive. If there are any challenges for corporates using the solution, most of these are internal and not directly connected to actual BPO processes.

"It is something which I think many companies who use the BPO will find," says Gary Slawther, Corporate Treasurer at OCTAL. "Trade finance people – logistics departments, for instance – know what they like and like what they know. They are generally experienced and have been using LCs for years, and trying to get people to change and use something new can therefore be quite a challenge."

For adoption among end-users to increase, it is vital that the benefits of the BPO are fully appreciated. For that to happen, the simplification which the solution can bring to trade operations needs to be more effectively communicated. Should that not happen then the level of corporate demand that banks need to take their propositions forward may never materialise. "If it is just seen as a bank product then there is a strong possibility that it will just wither on the vine," says Slawther.

Enrico Camerinelli, Senior Analyst at the Aite Group, agrees. In his opinion, the near exclusive focus on what the solution has to offer for banks is one of the reasons why the development of the BPO has been so protracted. "There is a tendency from banks to believe that if they solve their own problems the benefits will somehow ripple down to corporates. But that is not always the case," he explains.

The benefits are definitely there, however (see the box on page 20 for a refresher). The challenge for SWIFT and the banking community in the year ahead will be making sure that message is effectively communicated to corporate clients. "That means listening to their views and helping them build a business case for their involvement," says Camerinelli. If that important step is taken, then we should begin to see the solution adopted more widely in the year ahead, although it may still be some time before corporate use approaches critical mass.

Spreading the word

With eyes fixed firmly on presenting the BPO "in a more corporate-centric way", André Casterman, Head of SWIFT's Global Strategy and Business Development in the Corporate and Trade markets, admits that a fresh look at how it is promoted is needed.

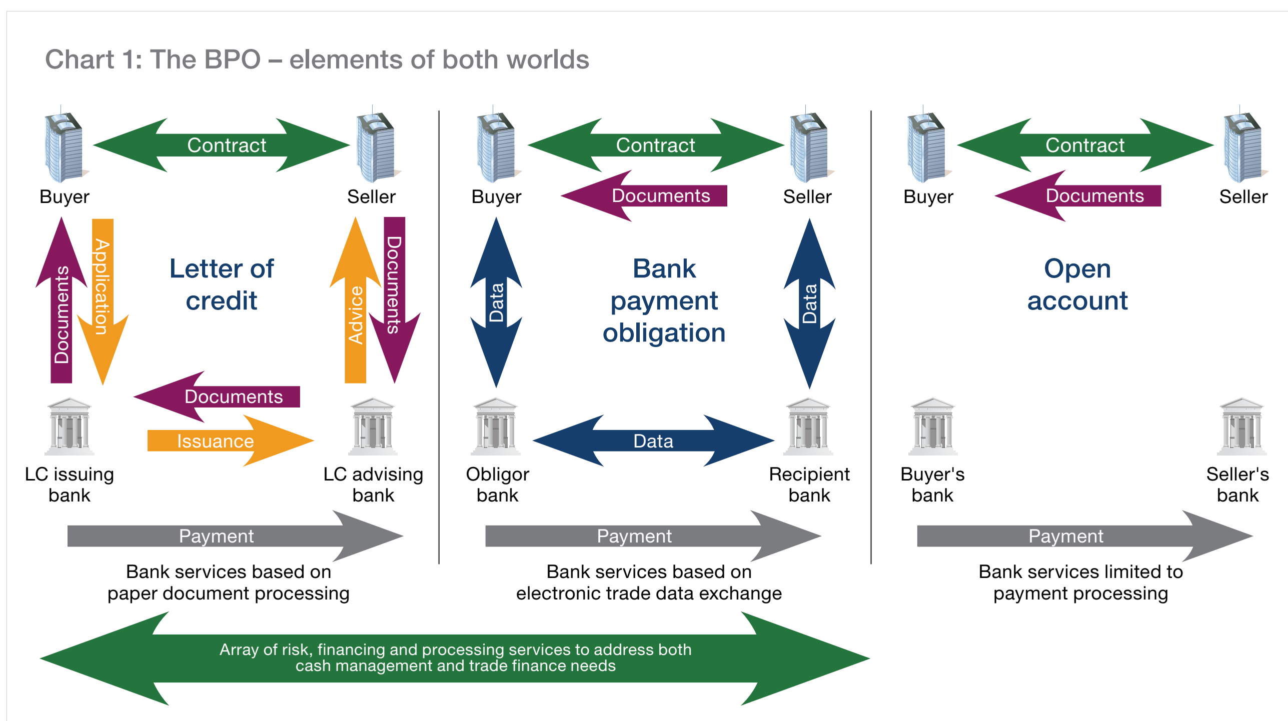
For Casterman, "it is no use talking about how it works" to corporates because corporates have no need to know – in the same way that a mobile phone user does not care how their network operates, only that it works when it is needed. So how is SWIFT going to drive interest in this potentially very useful trade product? Playing on the sheer practicality of the solution is a good place to start, it seems.

"What we will be doing in 2014 is working on industry-specific value propositions," says Casterman. There is logic to this focused approach. In certain geographies – intra-Europe, for example – the transportation of goods is rapid, but the paper trail is not. The traditional letter of credit (LC), as a paper-based document, will often land on the relevant parties' desks after the shipped goods have docked. It slows down the supply chain and receipt of payment to the point where letters of indemnity, much-disliked by the shipping protection and insurance (P&I) clubs –because they are complex and yet offer little real protection – are used to try to expedite flows.

To begin with, companies trading in commodities will remain the main focus for SWIFT in 2014. Casterman explains that typical deals in this space are sizeable, recurring and are typically between large corporates that have already established a high level of mutual trust. The market is also intensely competitive to the point where banking fees "are a secondary interest" when it comes to maintaining client relationships and thus anything that can speed up the trade flow and receipt of goods is welcome.

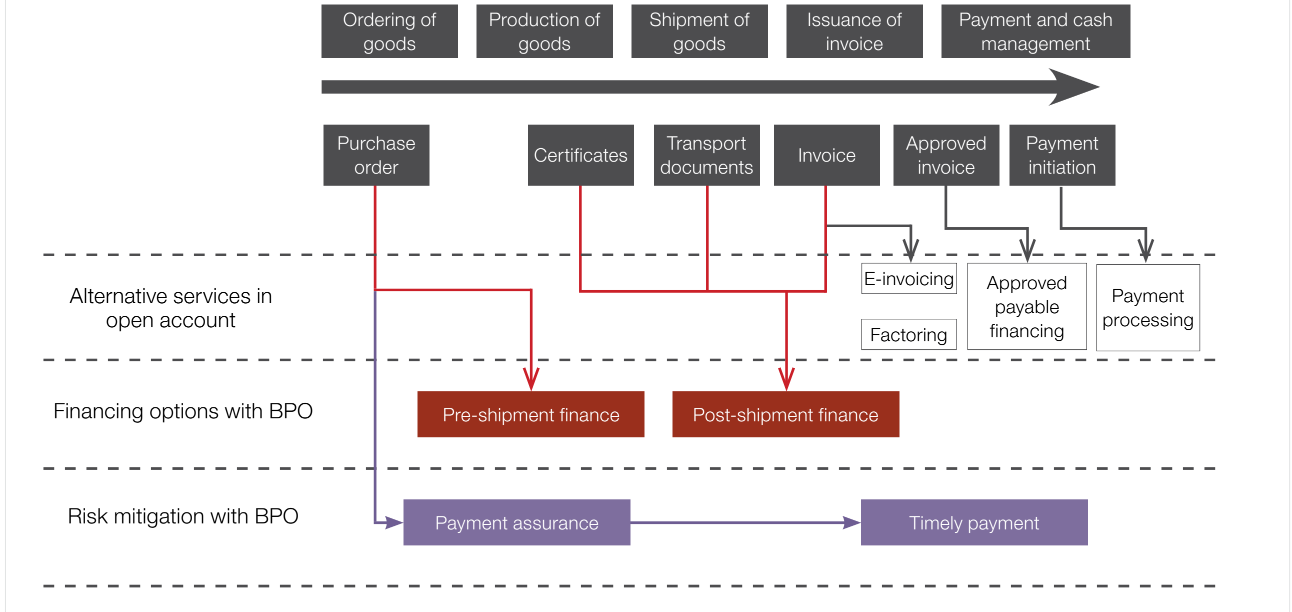
SWIFT is also seeking to demonstrate that regardless of the duration of the physical transportation process, the BPO will be beneficial for buyers. When a purchase order is agreed, if an LC is to be used it must be opened immediately because the documentation process is slow.

As an electronic document currently presented between banks via SWIFT's TSU, the BPO ensures that an LC can be opened at



Source: ICC Education Group, September 2012

Chart 2: Risk mitigation and financing in the supply chain



Source: Euro Banking Association at EBA Day

a much later point, where perhaps the exporter needs only to manage its risk as the shipment arrives – if the order is cancelled pre-delivery the shipment can be re-routed to a new buyer.

"We are aligning the use of credit lines to the real risks in the physical world," says Casterman, adding that over time the system under-pinning the BPO "will shift entirely to e-banking". Integration of trade solutions will be essential and SWIFT's commercial partners are being co-opted into the process. Trade finance solution vendors, such as Surecomp and Global Trade Corporation, already have SWIFT certification for their products. In order to keep that status, all vendors will need to combine the BPO – perhaps as a separate module – with the other instruments such as LCs and Guarantees.

So, perhaps the BPO has now found the problem to its solution, but convincing corporates of that fact will still take time. ■

BPO refresher: the essentials

The BPO is essentially an irrevocable undertaking given by one bank to another bank that payment will be made on a specified date, following a successful electronic matching of data. It functions in a way which is similar to both the letter of credit (LC) and open account settlement, but there are a number of crucial differences (see Chart 1).

For corporates, the BPO offers benefits in three main areas. The first benefit is improved risk mitigation (see Chart 2). In terms of documentary risk, the BPO has significant advantages over traditional trade finance products which are often vulnerable to discrepancies. For example, when using an LC, a participant in a trade may find the goods descriptions on their documents differ from that of their counterparty's.

However, with the BPO, purchase orders are agreed at the very outset using a data matching application – such as SWIFT's Trade Services Utility (TSU) – thus minimising the risk of confusion arising between counterparties further down the line. As this action is performed automatically, without the need for manual input, it also has the advantage of not requiring a large team to approve documents exchanged between the buyer and seller.

Next is the assurance the solution provides for sellers that they will be paid in full and on time. Unlike trade on open account, which offers no such assurance, the BPO functions rather like a confirmed LC. This leads in to the third main benefit – the opportunity for the seller to use the BPO as possible collateral for pre and post-shipment financing. Once the obligor bank has issued the BPO, the recipient bank knows that, providing their client ships the goods, repayment is covered.

At this stage, even if the shipment has yet to take place, and might not do so for months, the recipient bank could be prepared to provide its client with a percentage of the value of the BPO as pre-shipment finance. After the goods have been manufactured and shipped, data arrives from the supplier which is matched with the purchase order baseline and, at that point, the obligor bank's obligation to pay is crystallised.

This also has potential benefits for the buyer. Now that the seller is able to obtain pre-shipment finance, using the BPO as collateral, the buyer may be able to negotiate more favourable contract terms than would have been feasible previously.

The role of shadow banking

China is keen to play down concerns about the influence of shadow banking on its financial system, but recent pronouncements indicate that Beijing is fully aware of the damage informal lending could do to its plans for sustainable economic growth.

Warnings about the impact of shadow banking, where non-bank intermediaries effectively carry out traditional banking functions, on the Chinese economy have come from a variety of sources. For example, last July the IMF said it was 'increasingly urgent' for China to shift away from its credit-intensive growth model, which it said was 'not sustainable and is raising vulnerabilities'.

Many analysts and industry commentators have also made their viewpoints clear. Wei Yao, China economist at Société Générale Corporate and Investment Banking, says conditions are ripe for defaults, with slowing credit growth, elevated costs of funding, waning economic momentum and tighter financial regulation. Elsewhere Thomson Reuters refers to the implications of a rebound in China's average inflation rate, as the government could increase the deposit rate to curb inflation. A higher interest rate would reduce the net interest margin, thereby reducing the amount of funds flowing into shadow banking products and increasing the risk of a funds shortage.

Adding fuel to the fire, Nomura blames shadow banking for deepening income inequality and facilitating wealth transfer from the poor to the rich. Because many products are only available to high net worth retail investors, only the wealthy can take advantage of the implicit government guarantee, while the government will likely have to pick up losses (at least from local government financing vehicle-related investments) using public funds. Industrial and Commercial Bank of China's recent decision to bail out investors in its 'Credit Equals Gold No. 1' investment scheme has added to the sense that savers are effectively being insured against the effects of bad investment choices.

The role of shadow banking in China only appears to be increasing. The Financial Stability Board's 2013 global shadow banking monitoring report refers to a 42% increase in assets of 'other financial intermediaries' in China in 2012. According to analysis from Crédit Suisse, core Chinese shadow banking products were worth RMB22.8 trillion ($3.72

trillion) at the end of 2012, accounting for 44% of GDP and half of all new credit issued. Crédit Suisse likens some of these shadow banking products on offer to the collateralised debt obligations offered in the US before the financial crisis, albeit without established regulation and with even less surveillance.

A positive role?

However, a document circulated by the Chinese government in December refers to the emergence of shadow banks as an inevitable result of financial development and innovation and says that as a complement to the traditional banking system, shadow banks play a positive role in serving the real economy and enriching investment channels for ordinary citizens. The document also states that 'at present' the country's shadow banking risks are under control, although guidelines from the State Council call for tighter regulation of banks' off-balance sheet lending and say that trust companies – the biggest non-bank players – should return to their original purpose as asset managers and not engage in 'credit-type' business.

In a new report on the sector, XTEChina Consulting principal Tim Summers states that shadow banking probably does not pose a big threat to public finances right now, but that it may become a source of systemic risk if its rapid growth continues. "The main risks resulting from shadow banking are liquidity risk due to maturity mismatch, credit default risk from loans to weaker companies or projects and the exacerbation of already high corporate overstretch as shadow banking helps plug cash holes. There are few tools available to clearly identify or quantify these risks," says Summers.

He warns that while part of the demand for informal lending reflects growth potential from innovative or emerging companies, it also reflects a deteriorating environment for at least some corporations in China. "Cash flow pressures for many Chinese companies have grown over recent years. This means a growth in demand for credit, whether to invest in new capacity in an effort to grow out of crisis or simply for bridging loans to help manage cash shortfalls."

The shadow banking sector provides at best short-term benefit to borrowers who cannot obtain funding from the conventional banking sector for them to buy time to avoid a liquidity crunch, says Peter Wong, founding chairman, International Association of CFOs and Corporate Treasurers (China) and convenor, Hong Kong Association of Corporate Treasurers. "Lenders/investors and financial intermediaries are not assured a sustainable return as borrowers face very high interest costs. The social and economic costs for misallocation of capital will likely outweigh short-term expansion in loss-making fixed asset investment."

Wong expects increased competition resulting from interest rate liberalisation and deleveraging to force banks to apply sound credit risk management to improve lending margins. "In addition, development of the capital market – including reopening the A-shares IPO; promoting the RMB corporate bond market (especially the high yield segment); and increasing the role of professional/institutional investors will provide the much needed long-term funding and reduce the refinancing risks of bank loans."

Chasing shadows

One of the key questions going forward is whether Chinese regulators have the resources to properly police the shadow banking sector. Wong observes that there are already restrictions on shadow banking loans disguised as wealth management products, with banks distributing such off-balance sheet products facing reputational risk and compliance risk of misrepresentation as well as potential sanction by the China Banking Regulatory Commission (CBRC). "Other shadow banking lenders will be discouraged by a deteriorating credit outlook and will find it harder to obtain cheap funding in a tight money supply situation," Wong adds.

"The process of forcing the state-owned banks to increase their lending to businesses may take longer to achieve as they enjoy certain legacy advantages not accessible to smaller banks or newcomers, such as a sizeable deposit base from state-owned enterprises, lower funding costs with implied government support and comprehensive location coverage nationwide," he continues.

In early January 2014, the CBRC said it would implement a limited licence regime and set up three to five private banks on a trial basis in an effort to deepen reform in the domestic banking sector. It also said that it would explore lowering the threshold for foreign banks to enter the industry.

"The intention is for the new privately financed banks to fill some of the gap left by reduced shadow banking activity, although certain conditions will need to be put into place including a credible nationwide deposit insurance scheme, further development of the wholesale funding market and improved connectivity and accessibility of multi-bank ATM networks," Wong acknowledges. "That will provide a much more level playing field to newcomers on sourcing funds and service delivery." As an economist at the Manufacturers Alliance for Productivity and Innovation (MAPI), which is focused on increasing productivity and innovation in manufacturing, Yingying Xu is well placed to comment on the impact of shadow banking on commercial enterprises doing business in China.

She explains that shadow banking initially boosted export activity because most exporters are small- and medium-sized private businesses and the state-owned banks are mandated to lend to large businesses and state-owned enterprises. "It is only in the last three to four years that the exponential growth of this type of lending to local government (for infrastructure construction) has started to cause concern."

The issue that has made the largest contribution to the growth of shadow banking in China is the cap on lending and savings rates, which is controlled by the central bank. The state banks will not lend to small businesses because they cannot charge them higher rates than large corporations who have a lower risk profile. Therefore, small businesses have to rely on informal lending for financing, for which they pay higher interest rates – which attracts funding from both formal financial institutions and savers.

"Savers have limited investment options," says Xu. "The stock market has been depressed for several years and is blighted by insider trading, which has destroyed public confidence, so savers are looking to channel their investments into the informal lending sector."

"Stronger supervision and regulation will help to contain shadow banking in the short term and will not necessarily have a direct impact on formal lending. But to solve the root cause will need more radical policy change (such as interest rate liberalisation) and that can impact formal lending."

Reform needed

It has been suggested that Chinese regulators might be given additional resources to properly police the shadow banking sector, but Xu notes that the central bank has moved more rapidly over the last 12 months to liberalise the financial sector, for example by allowing the larger banks to relax the lending rate cap, ending the lending rate floor and allowing the inter-bank rate to be determined by markets.

"However, if the government maintains caps on lending rates and subsidises loans to state-owned enterprises there is no incentive for the banks to lend more to small businesses. One of the major elements that is missing from the liberalisation agenda is reform of state-owned enterprises." Privately financed banks would probably have more control over the interest rates they charge, but they would not address the problem of interest rate caps within the state banks, she adds.

"Without meaningful reform on liberalisation of interest rates, private banks wouldn't be able to charge higher rates to riskier borrowers and wouldn't be able to compete on a level playing field with state-owned banks to attract savings either. The Chinese banking system does not currently allow for proper risk assessment and it is unclear what regulations the privately financed banks would have to comply with. There is risk assessment in state-owned banks, but it is still at an early stage of development."

According to Chris Devonshire-Ellis, Chairman of Dezan Shira & Associates (which provides tax advice to foreign direct investors across Asia), a local government default this year would not be a surprise and he also refers to similar concerns around some of the smaller local banks. "We have seen this before. The government of Guangdong defaulted on its Guangdong International Trust and Investment Corporation vehicle in 1999 leaving investors (many of them foreign) out of pocket to the tune of $4.4 billion. Beijing refused to bail them out and I can see this happening again."

He is not convinced that shadow banking has produced any benefits to the Chinese economy. "While it is true that financing has been obtained, much of it is at high rates and I suspect much of that credit has gone on vanity projects and 'white elephant' infrastructure. China has a massive property bubble as a result and while the Chinese have continued to target and measure in simple GDP growth terms alone, this has led to many local governments and even state-owned enterprises investing in pointless projects just to keep their GDP rates high and at targeted performance levels."

Devonshire-Ellis claims that limiting the growth in loans created outside formal channels without significantly affecting the flow of credit into the economy can only be achieved at a cost. "This will manifest itself by institutions such as local government funds and trusts (as well as some banks) going to the wall. That will be a wake-up call that financing has to be provided by state channels, but the issue here is that even these are notoriously inefficient. China needs to liberalise its banking and financial sectors to sort this out, so there needs to be a dual effect – some sharp and painful lessons followed by reforms."

He believes China will appear rather less capitalist by the end of this year, but this does not mean that the state will automatically pick up the bill. "The people who invested in schemes like 'Credit Equals Gold No. 1' are wealthy Chinese – I think the Communist Party of China will just tell them to swallow their loss. If they complain they will likely face investigation as to how they accumulated their wealth. So the party will nip protests in the bud and blame a few corrupt bankers, businessmen and officials in the normal manner."

Devonshire-Ellis says increasing business lending by state-owned banks will require reforms at state-owned enterprise-level as well as in the financial and banking sectors. He expects the government to use what will be a messy period as an excuse to push through reforms in the wake of what he believes is going to be a series of bankruptcies during 2014, although these will be restricted to smaller banks and governments. "Then they will have a reason to push through the reforms that to date they have only been talking about. It will be a fait accompli by the reform faction over the traditional hardliners with their vested interests."

He is not optimistic that privately financed banks will become a major force, although it is possible that reforms and mergers could lead to the creation of some larger banks from what have until now been relatively small players. He also expects to see foreign governments or even banks take equity positions in some of these new institutions.

"I don't expect the CBRC to lower the entry threshold for foreign banks, but I do expect it to reform market entry and what these banks can do. This would also extend to insurance companies – China desperately needs to get its welfare system onto an insurance-based model and this will be part of any financial reforms, quite apart from the banking sector and easing out all that bad credit and failed schemes."

An alternative source of finance

In addition to the property sector, shadow banking has been utilised by industries with excess capacity (including coal mining and steel) as such businesses have faced difficulties getting loans from the formal banking system, explains Wang Ming, Director of Shanghai Yaozhi Asset Management. "The financial sector may be the most 'damaged' as shadow banking comes with notable default risks. The rescue of investors in the high yield trust distributed by Industrial and Commercial Bank of China to fund a family-run coal miner is a fresh warning."

Ming believes that it will be hard for the government to limit the growth of shadow banking as such a move would be very likely to seriously affect the property sector and slow down China's economic growth significantly. "Privately financed banks could fill a small part of the gap left by shadow banking, but I don't think they could do a lot since sectors financed by shadow banking commonly face larger default risks and the new banks are unlikely to ignore these risks."

He describes lowering the entry threshold for foreign banks as a long-term target for the CBRC. "I don't think such a move could take place this year or next, as the regulator needs to protect small banks (including the new privately financed banks) from competition from more experienced foreign banks."

Despite the dire warnings, it appears that shadow banking will remain a significant component of China's financial system for the foreseeable future. The authorities appear content to maintain current levels of lending, so the challenge for its practitioners will be to stay one step ahead of the regulators to deliver useful financial innovation while seeking short-term profit through regulatory arbitrage. ■

MOVING UP A GEAR

Chris Sutherland
Treasurer

When Chris Sutherland joined Transpower in 2011, he was not only tasked with overseeing the integration of a new treasury management system, but also needed to steer the business through a major capital restructuring. In this interview, Chris talks in-depth about the challenges Transpower's treasury team faced during this period of change, and describes how they rose to the occasion.

Transpower owns and operates New Zealand's National Grid – the high voltage transmission network connecting areas of generation with towns and cities across the country. The state-owned company keeps New Zealand's energy flowing by transporting bulk electricity, connecting with smaller lines companies and managing the nation's power system 24/7. Net profit after tax but before net changes in the fair value of financial instruments for the full year ended 30th June 2013 was $268.5 million, compared with $166.9 million for the full year to 30th June 2012. Transpower was named Energy Company of the Year at the 2013 Deloitte Energy Excellence Awards.

Starting out as a maths and economics teacher in a New Zealand high school, and subsequently working his way through a handful of banking and consultancy roles in Australia, Chris Sutherland moved back to Wellington from Sydney in 2011. He was looking for a job that would diversify his skillset and push him outside his comfort zone. The role of Treasurer at Transpower – New Zealand's National Grid operator – was the perfect opportunity.

Working for a state-owned company is a significant change from Sutherland's previous positions, not least because Transpower's key business activities are heavily regulated.

"Being a natural monopoly, Transpower is regulated by the Commerce Commission and the Electricity Authority in New Zealand. In fact, nearly 98% of Transpower's revenue comes from regulated activities," explains Sutherland. Interestingly, the Commerce Commission also sets a weighted average cost of capital (WACC) benchmark that Sutherland's team must either meet or exceed.

Regulation is therefore a key driver of organisational behaviour and decision-making at Transpower. As a result, the company's DNA is quite different to that of a typical corporate – as is the remit of its treasury function.

> "The company has five debt facilities: a domestic medium-term note (MTN) programme; an Australian MTN programme; a European commercial paper programme; a domestic commercial paper programme; and a revolving cash advance facility."

"We're a relatively small team – there are four of us in the treasury area – myself, the Assistant Treasurer, a Dealer and a graduate who works with us as a Treasury Analyst," says Sutherland. "We also have a Treasury Accountant and an Accounting Assistant who technically form part of the finance function, although they work very closely with us. My team is responsible for the company's funding and liquidity management, as well as Transpower's insurance programmes. We also oversee the company's enterprise risk management (ERM) processes, so it's quite a wide mandate for us."

Within corporate treasury operations in New Zealand, it is not unusual to have treasury and insurance sitting together, but ERM is not typically included within that remit. But it is precisely this kind of challenge that really appeals to Sutherland. Moreover, the role gives him significant exposure at board level and he also enjoys the relationship and marketing side of issuing debt to the public. The latter is something Sutherland has had plenty of opportunity to do as a direct result of the capital structure review that Transpower undertook in mid-2011.

Capital restructuring success

When Sutherland joined Transpower, the company was still considering how to change its capital structure. "The findings of the review highlighted that Transpower was perhaps not as leveraged as we could be in comparison with our international peers. At the time, we were around 50% geared and given that the company has a very high regulated income, we determined that we could move that gearing up a notch. We are now up to about 70% gearing. This is middle of the field when we look at the gearing levels of other international companies in our peer group," notes Sutherland.

"To achieve the capital restructuring, Transpower debt funded much of the capex throughout the peak of our capital cycle and also paid some additional dividends up to the government," he explains. The company has five debt facilities: a domestic medium-term note (MTN) programme; an Australian MTN programme; a European commercial paper programme; a domestic commercial paper programme; and a revolving cash advance facility.

As Sutherland outlines: "Most of the company's funding comes from New Zealand: we have a little over $1 billion in domestic bonds and we have around $200m in domestic bank debt. We then have around NZD $860m worth of USPP – equivalent to around USD $600-650m. In our European MTN and Australian MTN programmes, we have a mixture of currencies: Swiss francs, Hong Kong dollars, Canadian dollars and Australian dollars, totalling the equivalent of circa NZD $1.1 billion.

Sutherland's experience of issuing debt over the last two years has been rather mixed. "As the local market, issuing in New Zealand has always been easier for us and we undertook a really good issue in November 2013, raising $200m in five year bonds which were listed on the NDX Debt Market." Issuing offshore has definitely been more challenging. "It can be difficult to get the currency back into our domestic currency in terms of cost. This cross-currency basis cost factor narrows our windows of opportunity." Nevertheless, Sutherland's team undertook a successful Australian issue in August 2013, which saw AUD $300m in senior unsecured notes issued to Australian and Asian institutional investors.

Yet, despite its success, Sutherland is quick to point out that this issue was not without its challenges: "We were initially looking to issue early on in 2013, but when the US Federal Reserve started talking about tapering and caused the market to react, we decided to hold off and wait for the market to calm down. The fact that we were looking for a ten year tenor, and that we were first-time issuers in the Australian market, also made it a more challenging process."

> "We have seven relationship banks, which feels like rather a lot, but certainly isn't as many as other corporate treasury functions in New Zealand. Generally, we work closely with our relationship banks and they are a primary resource when we are looking to arrange a debt issue."

The hard work was worth it in the end though: one of the funding challenges Transpower faces going forward is being able to undertake more issues with longer tenors in order to better match its long-dated asset base. "Tenors on the local market tend to be relatively short, which doesn't necessarily cater to the needs of an infrastructure company. It's really encouraging to know that we can go to markets such as Australia and raise funds with the tenors that we want."

While Transpower's treasury team is obviously well-versed in debt issuance, the role that its banking partners play in the process is also vital. "We have seven relationship banks, which feels like rather a lot, but certainly isn't as many as other corporate treasury functions in New Zealand. Generally, we work closely with our relationship banks and they are a primary resource when we are looking to arrange a debt issue. The banks also help us with our hedging requirements – from interest rate to currency and commodity deals, as well as emissions trading." Transpower works with four

Australasian banks: NAB, Commonwealth Bank, ANZ and Westpac. The company also uses three international banks: Citi, Bank of Tokyo Mitsubishi and HSBC.

A watchful eye

Having now achieved its desired 70% gearing level, Transpower has reached the peak in its funding programme. "We're also keeping an eye on our key financial metrics, such as funds from operations (FFO) to interest, which we look to be no less than 2.8x and FFO to debt around 12-13% in order to maintain a level of prudence."

"I've been fortunate to work with some very good managers in my time and I've really been able to put their behaviour and proactive approach into action at Transpower. The most important thing that I learned from them is that 'the only constant is change'."

To help his team keep an eye on these metrics; the company's risk exposures; and to carry out day-to-day treasury tasks in an efficient manner, Sutherland's department runs three IT systems. "We use a TMS called Visual Risk which is from an outfit based in Sydney. When I first arrived at Transpower, we were using a treasury system called Integrity. The problem was that we were running an unsupported version so we couldn't continue on with it."

Visual Risk had already been selected as the preferred platform for Transpower's treasury team to migrate over to and there was a project underway to make that happen. "I picked that project up in the very early stages. There were a few challenges in implementing the new system and making it fully end-to-end, but we've overcome those now. In fact, I find it a very good system and I'm quite encouraged by it," Sutherland notes.

For risk management, Sutherland's team uses two systems, the first of which is supplied by Quantate, a Wellington-based provider of web solutions for enterprise governance. The Quantate system can be configured using the company's own evaluation criteria and helps in the identification and assessment of risks, as well as allowing for recording and monitoring of relevant controls. The second system is CS Vue. Transpower uses this system to track and monitor compliance with obligations under borrowing programmes.

In addition to these three core systems, Sutherland's team, also uses Excel spreadsheets "quite a bit" in the day-to-day running of Transpower's treasury function. "They're a very flexible and useful business tool," he adds.

Pushing ahead

Despite being "comfortable" with the systems he now has in place, Sutherland is not one to stand still. Automation around the TMS is ongoing and he is now looking to automate the rates upload, which currently requires some manual intervention. He is also looking to enhance the bank reconciliation process through further automation. "This will improve the team's working lives and will also cut down on errors and rework," he observes.

Once completed, Sutherland will be able to add this to the list of the treasury team's achievements under his leadership. That list currently includes the raising of $1.5 billion dollars of debt with full support from the company's board; listing on the New Zealand Stock Exchange debt market for the first time; and adjusting the company's insurance to accommodate the additional asset base that Transpower has been building over the last two years. Considering the relatively short time that Sutherland has been at the company, that is impressive work.

Explaining these achievements, he says: "I've been fortunate to work with some very good managers in my time and I've really been able to put their behaviour and proactive approach into action at Transpower. The most important thing that I learned from them is that 'the only constant is change'. This means that you have to be resilient. Never be surprised by change – be encouraged by it and embrace the challenges that change brings." ■

Key financials

12 months to 30th June 2013	2013	2012	2011	2010	2009
Total revenue[1] ($m)	920	785	731	730	694
Earnings before net changes in fair values of financial instruments ($m)	269	167	126	142	136
Funds from operations interest coverage (Times)	2.9	2.9	3.2	3.9	4.0
Total debt at face value[2] ($m)	2,937	2,319	1,746	1,413	1,190
Non current assets, including held for sale assets ($m)	4,822	4,389	3,676	3,144	2,747
Total equity ($m)	1,410	1,509	1,534	1,455	1,400
Return on equity[3] (%)	12.1	11.3	8	10	10
Total debt/total capital (%)	68	61	53	49	46
Dividends[4]	295	315	0	0	0

[1]Excludes interest revenue
[2]After adjusting for related foreign exchange derivatives
[3]Excludes discontinued activities
[4]Includes the interim and final dividend related to that year as well as special dividends

Running a tight ship

From fraud to human error and natural disasters, operational risks can hit corporates in a number of ways – and can prove very costly. As awareness of these risks increases, and the technology and solutions available to help mitigate them become more sophisticated, treasurers are increasingly well-equipped to tackle this crucial area of risk management.

Managing operational risk, or rather failing to manage it correctly, can be a costly business. Look no further than recent newspaper headlines for proof of that.

In January 2014, J.P. Morgan agreed to pay $2 billion in penalties to settle charges relating to its involvement in the Bernard Madoff Ponzi scheme. Some of the oversights in operational risk management highlighted by the US federal prosecutors' action against the bank were startling. In 2007, for example, the chief risk officer of J.P. Morgan's investment bank agreed to increase its exposure to the Madoff entity to $250m, despite the fact that Madoff refused any further due diligence of Madoff securities.

Last year Chinese securities brokerage Everbright Securities triggered an investigation of stock trading systems at all brokerages in the country after a glitch in its trading system caused it to mistakenly make RMB23.4 billion ($3.9 billion) of buy orders. This systems slip was the largest trading error in Chinese stock market history.

But it is not just financial services firms that are subject to operational risk – it is a huge concern for corporates, too. So what should treasurers be looking out for and how can they help the company to stay on top of its operational risk?

Disruption to business

To answer these questions, it is important to first define and classify operational risk. In broad terms, it is the risk of loss resulting from inadequate or failed internal processes, human behaviour, systems or from external events. Examples can include fraud, by employees or outsiders, human error, and audit risk – where auditors may not understand the specificities of a company as well as an insider. External events that pose risks to corporates include movements like the Arab Spring that started in 2010, banking crises, such as the one that took place in Cyprus in 2013, and environmental risks, such as extreme weather.

What all these causes of operational risk have in common is their outcome: disruption to the company's operations – which obviously carries the risk of financial loss. It can also create the less tangible risk of reputational damage. In some cases this may result in litigation from customers, suppliers or other stakeholders. Between 2009-2011, multiple recalls of Toyota cars over possible manufacturing faults were not only costly – forcing the Japanese carmaker to cut 750 jobs at its main UK factory – but also made a significant dent in the company's previously decent reputation for safety.

With the economic shocks of the last few years making commercial life tough enough, it's little surprise that corporates are intensifying their focus on operational risk and looking to plug any gaps. "Since the financial crisis, the majority of CFOs and treasurers have had greater responsibility for operational risk, which has led to more time and resources being devoted to its management. This is driving a need for greater automation through business-as-usual treasury processes, in order to give the treasurer the capacity to focus on these additional tasks. Operational risk needs to be dealt with in a long-term, strategic way – the best operational risk solutions balance efficiency with resiliency and sustainability," says Mike Edwards, Head of Solution Packaging and Communications, GTS, EMEA at Bank of America Merrill Lynch.

One way for corporates to assess their ability to manage certain operational risks is through stress testing. This is where companies explore what-if scenarios and try to predict their impact on the business using computer-generated simulation models.

Other technology can also help. Straight through processing (STP), whereby capital market and payment transactions are carried out electronically using a one-touch system, is one option. "From a technology perspective, straight through processing really does help reduce operational risk, as it eliminates the need to constantly re-key information into lots of different systems," says Shen Lee, Senior Manager, Commodities specialist in Corporate Treasury Services at Deloitte.

STP reduces settlement risk, as well as allowing settlement and confirmation information to be drawn from the same source. It also reduces the risk of fraud. "There are various levels of authorisation on these systems that do not exist with traditional paper-based systems, with records of log in times and details of who is doing what. This obviously reduces the risk of fraud. If the systems are built in the right way, it creates the right segregation of duties that makes the whole process much more efficient – and it mitigates risk," adds Dino Nicolaides, Director, Head of Treasury Advisory Services in Banking and Capital Markets at Deloitte.

Despite the technology now available to help treasurers manage operational risk, oversights do still take place. "No specific infrastructure or system can be perfect, and there's always the risk of human error or something falling between the gaps," says Nicolaides. "But now a lot of big corporates are taking this very seriously. Operational risk management systems and infrastructure need to be revisited at regular intervals to make sure you identify, as the business changes and moves, how the infrastructure and the mitigating factors you have in place are adapted accordingly," he adds.

Regulation impacting operational risk management

- **SOX** – corporate governance failures at several large US multinationals in the late 1990s and early 2000s, notably Enron and WorldCom, drove the passing of the Sarbanes-Oxley (SOX) Act, which regulates internal controls and the transparency of financial reporting.
- **EU** framework – in the EU, listed companies are subject to a governance framework that is a combination of statute and 'soft law', a term that covers recommendations and corporate governance codes in member states.
- **Asia** – regulation around corporate governance and operational risk management varies from jurisdiction to jurisdiction. In China, for example, China SOX, or C-SOX, is the basic standard for enterprise internal control and has been adapted from US SOX.

A risky environment

Environmental risk is an area of operational risk that is becoming a much higher priority for corporate treasurers, particularly for those active in some Asian markets. We will therefore focus on environmental risk throughout the remainder of this article.

In a 2013 survey of weather-related risks in Japan, South Korea, China, Taiwan, Vietnam, Thailand, Indonesia and the Philippines, Munich Re said 45% of the major events in the 30-year period under consideration were floods. This was followed by storms (39%) and forest fires, heatwaves and droughts (16%). "There is no region of Eastern Asia that is immune to the threat of flooding," commented Peter Höppe, Head of Munich Re's Geo Risks Research unit, on the findings. The insurer said weather-related losses in the past three decades have caused losses of around $700 billion in Eastern Asia.

Eastern Asia weather events

- Japan – in 1991 Typhoon Mireille caused a loss of $10 billion. Thirteen years later, in 2004, Typhoon Songda led to a loss of $9 billion.
- South Korea – super Typhoon Maemi, which hit the country in 2003, caused a loss of $4.8 billion.
- China – flooding of the Yangtze and Songhua rivers in 1998 caused a loss of more than $30 billion.
- Taiwan – Typhoon Morakot in 2009 caused a loss of $3.4 billion.
- Thailand – the 2011 flood led to a loss of $43 billion.

Source: Munich Re

Environmental risk covers more than just weather-related events, although this is one of the biggest risks. There are two broad ways of looking at environmental risks. The first is the impact a company can have on the environment. This can potentially damage a company's reputation and may lead to fines or penalties being imposed on the company. In extreme cases it may even result in a corporate losing its social licence to operate in a certain territory. For example, oil and gas multinational BP is on course to pay over $7.8 billion in compensation payments as a result of the 2010 Deepwater Horizon disaster in the Gulf of Mexico.

There are also risks from the environment on a company. These risks include anything in the natural world – for example a loss of access to water, earthquakes or flooding – that could potentially affect corporate performance.

On the up

Awareness of environmental risks is coming to the fore for a number reasons. One is that companies are being forced to internalise more and more of the costs of their operations.

"Previously companies were allowed to pollute many parts of the world in which they operated relatively freely. However with rising concerns over the health impact, the social impact, and the environmental impact of pollution, we're seeing increasing regulatory stringency on the ability of companies to externalise those costs," says Dr James Allan, Head of Environment and Climate Change at risk analytics, research and strategic forecasting group Maplecroft. The externalisation of these costs can take the form of carbon policies or technical requirements for energy efficient equipment.

The international expansion of many companies into territories where they have no experience is also making the management of environmental risk more of a priority. "More and more businesses are now operating in parts of the world where there's a greater exposure to environmental risks that are relatively unrecognised. There's a real lack of understanding of the level of risk in certain locations – for example, of flood risks in some of the developing parts of China, South-East Asia or some of the other growth markets," adds Allan. In addition to this uncertainty, a large number of corporates also lack understanding of resource scarcity and its implications, which can impact their ability to function without business disruption in the long term.

Environmental risk is becoming more of a Board-level issue. Previously seen as a technical or engineering challenge, it is now increasingly considered a strategic one, which can pose a problem for directors who are not familiar with this kind of risk. "It's sometimes difficult for Boards to identify the environmental risks that they might be exposed to across their entire corporation, and to know what sort of information they might need, how they're going to process it, and how they can then make decisions based on the information they have been able to collect," comments Allan.

A strategic issue

The making of environmental risk a Boardroom issue has been driven in part by pressure from stakeholders, including regulators and shareholders, who want a clearer understanding of how corporates are assessing and responding to these risks. As a result there has been a trend towards greater disclosure of companies' environmental liabilities.

The management of environmental risk can be carried out using a three-step approach.

1. **Check vulnerability**. A company's vulnerability to environmental risks may be linked to its direct operations or embedded in its supply chain. The company can collect historical information on this vulnerability or information on the current risk exposure.

2. **Assess the risk**. Identifying the high-risk areas is the next step. This allows companies to develop approaches to mitigate the ones that pose the greatest danger to the business.
3. **Implement a strategy**. Once the responsibility for environmental risk has been assigned and awareness has been increased in the organisation, the company can start to manage the risk on an ongoing basis.

Financial risk transfer methods, such as weather derivatives, can prove an effective way of hedging against some environmental risks, particularly in emerging countries. The Chicago Mercantile Exchange (CME) lists more than 60 options and futures contracts on precipitation and temperature. The pricing of these derivatives is complicated by the fact that the asset underlying the contracts is not a saleable commodity itself. High yield catastrophe bonds, which pay out in the event of certain extreme weather events, such as hurricanes, are also available, though little used by corporates.

Technological advances have contributed to the monitoring of environmental risk. The Gravity Recovery and Climate Experiment (GRACE), carried out jointly by NASA and Deutsches Zentrum für Luft- und Raumfahrt (DLR, the German Aerospace Centre) is a case in point. GRACE satellites collect climate change data across the world, monitoring minute changes in groundwater levels. Information from GRACE is publicly available.

"Technologically there's been a real advancement in the information available and in the science underpinning it. In particular the information available on climate change is developing all the time," says Allan.

Climate change

Indeed, climate change looks set to become one of the biggest environmental risks to corporates in the near future. Statistics from Maplecroft suggest that by 2025, 31% of world economic output will come from countries that are considered a high or extreme climate change risk – that is 50% greater than the current output of such countries. Maplecroft publishes a climate change vulnerability index every year, ranking countries and cities according to their resilience to climate change risk. Companies operating in Asian growth economies in particular are set to face rising environmental risks over the coming decades, with Dhaka in Bangladesh, Mumbai and Kolkata in India, Manila in the Philippines, and Bangkok in Thailand ranked as the most at-risk cities in the 2014 ratings. Bangladesh was ranked as the most at-risk country.

The index is based not just on physical exposure to climate change, such as changes in temperature and precipitation, but also on vulnerability, including population sensitivity and the ability of countries to adapt to the impacts of climate change. "A lot of the growth markets are highly vulnerable to climate change, because they're more prone to extreme weather events than some western European and north American markets, but also because they sometimes lack the same level of socio-economic resiliency to manage those impacts," says Allan.

Though not in the top ten, Pakistan and Vietnam are considered at extreme risk to climate change, and Indonesia, Thailand, Kenya and China are considered at high risk. India was also highlighted in the 2014 study as vulnerable to climate change events. Maplecroft drew particular attention to Cyclone Phailin, which caused $4.15 billion of damage and wiped out key infrastructure in the country's key mining region.

The United States on the other hand, though still subject to natural risks, is considered less vulnerable. In the 2013 rankings, New York was ranked 41 out of 50 cities in terms of its vulnerability to environmental risk and was considered medium risk – Maplecroft cited the city's ability to cope with Superstorm Sandy in October 2012 as proof of this.

The Chinese cities of Shenzhen, Guangzhou, Dongguan and Foshan, the last three of which are located in the Pearl River Delta – the core of China's manufacturing heartland – are said to be among the most exposed to physical risks from extreme climate-related events in the 2014 rankings. The inclusion of these cities may well be of concern to companies that use China as a manufacturing base. London and Paris were the only cities considered as low risk in the 2014 rankings.

Climate change vulnerability indexes

Countries

1. Bangladesh
2. Guinea-Bissau
3. Sierra Leone
4. Haiti
5. South Sudan
6. Nigeria
7. Democratic Republic of the Congo
8. Cambodia
9. The Philippines
10. Ethiopia

Cities

1. Dhaka (Bangladesh)
2. Mumbai (India)
3. Kolkata (India)
4. Manila (The Philippines)
5. Bangkok (Thailand)

Source: Maplecroft

Environmental risk checklist

As environmental risk becomes more of a strategic issue, corporates need to size up the threats they face. Even those operating in territories considered relatively low risk could be up against what are sometimes called 'unknown unknowns'. To assess the risks, there are several steps corporates can take:

- Know the risk – what are the biggest threats? Which natural hazards and environmental risks could hit your region? These risks include floods, mudflows, droughts, mass movements, avalanches, forest fires, earthquakes and tsunamis, volcanoes, air pollution and water pollution.
- Know the solutions – this is often in the form of insurance. Derivatives can also be useful in hedging against certain weather risks, and in some extreme cases catastrophe bonds may be an option. Corporates can also speak to the national meteorological agency in their country and familiarise themselves with the latest data collection technology.
- Know the legislation – corporates also have obligations in terms of their impact on the environment. In China, for example, the Ministry of Environmental Protection (MEP) and the China Insurance Regulatory Commission (CIRC) require compulsory purchase of pollution liability insurance by companies with high environmental risks. ■

Point of View

Independent industry analysis from our corporate treasury insider.

India: payments post crisis

I recently had the pleasure of working on Indian domestic treasury issues again, after a few years during which I had been more focused on other countries.

What a difference those few years make!

The India of my memories was a caricature nightmare of clearing times measured in weeks for so-called "up country" or "out station" cheques and byzantine bureaucracy. It was so awful that you just had to laugh – a lesson in acceptance worthy of any ashram.

Of course the licence raj is still thriving, and – regrettably for India's people other corruption and inefficiencies remain problematic. However, someone lit a fire under India's payment infrastructure and the progress has been remarkable in absolute terms and amazing in the context of India's progress in most other areas.

For high value payments, India has a real-time gross settlement (RTGS) clearing system which is fast and widespread. Clearing is through the Reserve Bank of India (RBI) and is final. RTGS is also the final inter-bank clearing for the low value systems.

The early low value clearing systems are national electronic funds transfer (NEFT) and electronic clearing service (ECS). NEFT has become common for credit transfers. NEFT is a net settlement system with 12 clearing cycles from 08:00 to 19:00 daily. ECS is commonly used for direct debits, but its popularity is limited because of its paper-based mandate management. The newer NACH (below) addresses this and other issues.

In 2008, the RBI established a private company called the National Payments Corporation of India (NPCI) to set up and run low value payment systems. The shareholders are banks, including two foreign banks – HSBC and Citi.

NPCI started by setting up an efficient low value clearing system based on international best practice. The National Automated Clearing House (NACH) provides both credit transfers and direct debits including electronic mandate management, using ISO20022 standards. NACH is being phased in to replace NEFT and ECS.

Electronic settlement already accounts for some 95% of value of INR (Indian Rupee) settlement and 50% of volume. These are nationwide figures – MNCs (multinational corporations) report higher figures. Even for companies using a lot of cheques, the situation has improved greatly.

The RBI mandated that all banks implement a core banking platform (CBP) to support electronic settlement and to enhance cheque processing. CBP enables so-called SPEED clearing of cheques using magnetic ink character recognition (MICR) and cheque truncation system (CTS). The net result is that 99% of cheques now clear within 48 hours.

CBP and electronic payments support a 30-character alpha-numeric account number field. Many local and global banks have built robust virtual account capabilities on the back of this. The best allow corporate customers to define virtual account codes on the fly, without the administrative overhead of setting up virtual account codes at the bank before use. And the RBI mandate means that the virtual account code entered by the payer will survive through any intermediary bank systems to arrive intact at the beneficiary.

"In 2008, the RBI established a private company called the National Payments Corporation of India (NPCI) to set up and run low-value payment systems. The shareholders are banks, including two foreign banks – HSBC and Citi"

A very interesting, albeit still early stage, initiative of NPCI is IMPS. Initially, IMPS stood for Indian mobile payment system, but the evolution and use case has been so rapid that IMPS has been rolled out as a multi-platform service and renamed IMmediate payment system.

IMPS provides real-time and final settlement retail payments, requiring only an online device and a bank account. So it enables the shift from cash to electronic in markets and bazaars all over India. IMPS has also generated enthusiasm from insurance companies, telecom operators and other corporates with high volumes of retail collections.

It is a fast-moving space globally, but IMPS has to be a strong contender for the most sophisticated and usable mobile payment system worldwide.

Where cash is still unavoidable – think field force petty cash and so forth – India's ATM network works across banks and although there is a nominal fee for inter-bank cash withdrawal most banks seem happy to waive it for corporate customers. An adjacent technology that is gaining popularity in such cases is the use of corporate-issued debit cards.

Statutory payments used to be a nightmare, requiring companies to maintain accounts with state banks solely to pay local taxes. The government is pushing for all statutory payments to be multi-bank, taking advantage of the new electronic payment platforms. Further, most global banks and large local banks have the correspondent banking relationships required to handle statutory payments nationwide. This helps treasurers to drastically reduce the number of bank accounts required in India.

Cynics might at this point be thinking that all this impressive bank payment infrastructure must be confined to limited pilot schemes in the big metropolitan areas. Not so. These are all live nationwide rollouts. Building on the back of RBI-mandated CBP, almost all banks are online. India is a huge country so I am not sure whether a remote corner like Port Blair in the Andaman Islands would be online, but 99% of India's GDP is covered and all of the big banks, both global and local.

My focus has been primarily on domestic INR settlement but I would be remiss if I did not mention a couple of adjacent issues.

FX controls have traditionally been a drag on productivity and efficiency because of the requirement for paper documentation for all cross-border flows. Much of that remains, but the RBI has delegated checking of trade documentation to commercial banks. This allows the banks to provide process efficiencies such as allowing scanned supporting documents to be provided online through e-banking along with payment instructions. (Of course, paper documentation must be available for subsequent audit where required.)

On a less positive note, India's Companies Act 2013 has made cash concentration even more difficult. Cash pooling has never been easy in India – notional pooling is not allowed and sweeping creates what the Act calls "inter-corporate deposits" which are strictly controlled to stop local conglomerates from shifting funds between partially floated affiliates. MNC cash management is collateral damage. The new Act makes cash pooling more difficult but care with company directors can normally resolve issues arising from the common directors rules.

India has leapfrogged several generations of payment technology in an astonishingly short time – broadly five years. In terms of payment infrastructure, India is now in the top league. For the sake of a billion Indians suffering from corruption and inefficiency, I hope this astonishing leap in payment technology becomes the model for other reforms. ■

David Blair, Managing Director

Twenty five years of management and treasury experience in global companies. David Blair was formerly Vice-President Treasury at Huawei where he drove a treasury transformation for this fast-growing Chinese infocomm equipment supplier. Before that Blair was Group Treasurer of Nokia, where he built one of the most respected treasury organisations in the world. He has previous experience with ABB, PriceWaterhouse and Cargill. Blair has extensive experience managing global and diverse treasury teams, as well as playing a leading role in e-commerce standard development and in professional associations. He has counselled corporations and banks as well as governments. He trains treasury teams around the world and serves as a preferred tutor to the EuroFinance treasury and risk management training curriculum.

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The views and opinions expressed in this article are those of the authors

The hedge of darkness

All businesses are exposed to market risk of some form. A common response is to hedge against those risks but in accounting terms this can create undesirable P&L volatility. Hedge accounting may be an effective remedy to this problem, but it can be a demanding process. Treasury Today calls upon a number of experts to shed some light on this dark art.

As deep and mysterious topics go, one of the clear leaders of the pack in financial circles is hedge accounting. It can strike fear into the heart of even the most seasoned finance professional. But, notwithstanding its complexities, it can be an effective means of mitigating the risk of potentially damaging volatility in profit and loss (P&L) accounts caused by the mark-to-market fluctuation of a hedging instrument and allowing a better reflection of economic performance to be provided. It is a voluntary accounting process (it has been described as a privilege, not a right) but for those that use it – typically listed companies whose accounts are exposed to public scrutiny – it must be applied with precision.

So what is it? A business may hedge financial or non-financial assets or liabilities by using a financial instrument in order to manage its exposure to a risk it may have around interest rate, FX, equity, credit or commodity price, for example. Accounting requirements often insist that assets/liabilities (frequently recorded at amortised cost or as a forecast item not yet recognised on the balance sheet) and the instrument used to hedge (which is accounted for as a trading instrument at its market valuation – in other words 'fair value' recognised in the P&L account) are accounted for differently. But where differences in measurement arise, such as between the fair value measurement of the hedge and the amortised cost for the assets/liabilities, a mismatch in the valuation or timing of income statement recognition is created, giving the appearance of corporate earnings volatility, which does not provide useful information to investors and shareholders.

Enter hedge accounting, which can be used as a means of reflecting the relationship between an asset/liability and the associated hedging instrument (for example by re-measuring the asset/liability for the hedged risk and recognising that value change in P&L to provide an offsetting effect with the measurement in P&L of the hedging instrument).

As long as the hedge is fully effective (more on this later) most mismatches in the P&L should be evened out by the relationship between the two and thus the business can better depict its performance through its financial statements.

Accounting bodies

Hedge accounting has a strict set of rules and requirements. These are typically laid out in the standardised accounting guidelines of each jurisdiction known as 'generally accepted accounting principles' (GAAP). In Singapore, for example, it is the Accounting Standards Committee (ASC) that is in charge of standard setting. In the US, hedge accounting under GAAP is tackled by the country's Financial Accounting Standards Board FAS 133 rule-set (now known as ASC 815).

When hedging structures are complex, there may be judgements to make where the local accounting standards "do not necessarily address all the possible scenarios", according to Yann Umbricht, Partner and Treasury UK Leader at PwC. He adds that for listed companies accounting at group level, alongside appropriate local GAAP reporting requirements for individual entities, international accounting standards must normally be applied. In this respect, the IFRS Foundation was established to develop and promote a single set of globally accepted accounting principles (known as International Financial Reporting Standards or IFRS). It works through its independent standard-setting body, the International Accounting Standards Board (IASB), and has global influence. Members of the IASB are responsible for the development and publication of IFRS, which is applied in over 100 countries, including two-thirds of the G20.

Hedge accounting requirements are contained in IAS 39 Financial Instruments: Recognition and Measurement, much of which had its genesis in similar requirements in US GAAP.

Pierre Wernert, Senior Consultant at Zanders Treasury and Finance Solutions, offers the following information on the conditions that must be met prior to hedge accounting under IAS 39:

- At the start of the hedge, the hedged item and the hedging instrument has to be identified and designated.
- At the start of the hedge, the hedge relationship must be formally documented.
- At the start of the hedge, the hedge relationship must be highly effective.
- The effectiveness of the hedge relationship must be tested periodically.
- Ineffectiveness is allowed, provided that the hedge relationship achieves an effectiveness ratio (the level of offset between the two) of between 80% and 125%.

Adopting IFRS 9

Following a consultation period, the section of IAS 39 relevant to hedge accounting has been updated. According to Umbricht, the new requirements, published under IFRS 9, are intended to reflect business and investor concerns that hedge accounting is "too complicated" and that it unnecessarily excludes some "very well-defined and acceptable hedging strategies".

IFRS 9 will eventually replace IAS 39. Currently, from an IFRS perspective, the new standard is available for application but in some jurisdictions, such as in Europe, IFRS 9 has not yet been endorsed for inclusion in European law. US GAAP must be used by US companies, of course, but IFRS standards including IFRS 9 can now be used in that jurisdiction by foreign businesses that need to file group reporting by US regulations (such as an entity that has listed debt in the US).

The switch to IFRS 9 for users of hedge accounting was due to become mandatory on 1st January 2015 but amendments made to IFRS 9 in November 2013 removed the mandatory effective date (although, as before, businesses in jurisdictions that use IFRS may still choose to apply IFRS 9).

The hedge accounting requirements in IFRS 9 are intended to be less administratively burdensome than IAS 39 by being more closely aligned with risk management. As part of the discussion that led the IASB to make these changes, it was clear that investors in business wanted to be able to understand the risks faced by a particular entity, what its management is doing to manage those risks and how effective those risk management strategies are, says IASB Board Member, Sue Lloyd. It is thus the IASB's intention "to more closely align hedge accounting with risk management" and to make the presentation of information more accessible to non-accountants. It is, she comments, "a new generation of hedge accounting".

IFRS 9 retains requirements for documentation of risk and hedging processes. It requires enhanced disclosure around exactly what those risk management activities are when applying hedge accounting. From an auditing viewpoint there are specific requirements to state what will be treated as a hedge accounting relationship and how each will be executed. "Hedge accounting is still complex," states Umbricht. The changes will not make it easy, "but it will become easier".

The role of technology

Blaik Wilson, chairman of treasury technology vendor Reval's Hedge Accounting Technical Taskforce believes the inherent complexity of hedge accounting, under any ruleset, lends itself to technological intervention. "Companies can enable rules-based processes and workflows which will only allow a hedge relationship to be created, and hedge accounting be conducted, if the appropriate documentation is in play," he explains. Such solutions – either outsourced or controlled by organisations themselves – can take account of local variations not just of the rules but also in how documentation must be presented; the latter giving rise to the use of templates. "If you haven't got a robust workflow attached to your processes, elements will be missed," he warns.

Inappropriate or missing documentation is the number one reason for a hedge ceasing to be eligible for hedge accounting treatment. "One of the reasons it gets picked up frequently is that it is quite an easy audit point to discover, and you've either done it correctly or you haven't," he notes. "Companies have to be vigilant in their processes to ensure they document every single one of their hedges correctly."

What's new?

Despite claims of reduced administrative burden, for example by using more economic concepts to determine whether a relationship is eligible for hedge accounting, IFRS 9 will almost certainly introduce extra work for preparers of financial statements when it comes to disclosure, admits Lloyd. But by

providing information that has been designed to help users of financial statements understand the effects of hedging on future cash flows, she argues that it gives a business "the opportunity to better explain its story".

There are other benefits. For example, companies can now hedge risk components in non-financial items. "IFRS 9 gives companies the ability to use risk components, slicing and dicing the hedged item for risks in non-financial items in the same way as for financial items, as long as the component is reliably measurable and separately identifiable," explains Ian Farrar, partner in PwC's Global Accounting Consultancy Services group and leader of PwC's corporate treasury practice in Hong Kong and China. This, he adds, will be "really useful" for companies dealing with commodities. "If you buy something that has high copper content, with IAS 39 you would have to hedge the whole item; now with IFRS 9 you can just choose to hedge the copper content." The same componentised approach to hedging applies to airlines and jet fuel, for example. The change effectively means more entities will be able to apply hedge accounting to reflect their risk management activities.

Aggregated exposures – those that have a derivative and non-derivative together – can also now be hedge accounted. The treatment of net positions is changing too. IAS 39 does not allow aggregation of items that have off-setting risk. With IFRS 9 it is now possible, for example, to designate a hedge of both sales and purchases on a gross basis with a net derivative. The downside explains Farrar, is that it is not permissible to recognise those gains and losses within revenues and cost of sales, for example; they have to be reflected in a separate line in the income statement. "In terms of presentation this is not perfect, but certainly it is a big step forward from where we are today."

There is however a "slight narrowing" of what is possible in terms of using undiscounted spot, notes Umbricht. He points out that application of IAS 39 has been "fairly flexible" when using the spot element of a forward contract to hedge a foreign currency risk that will occur in the future, where the time value of money could be ignored. If a company with a future dollar exposure took a dollar contract, the spot element was fully offset. But, he comments, the IASB has been "very clear" in its requirement to take into account the value of money, and discount back to present value both the hedged item and the hedging instrument. "It's all fine if the timing is very similar or the interest rate environment of the country where you operate is low," he notes. "But where you have uncertainty around the timing of the hedged item, and a higher interest-rate environment, this may create more ineffectiveness than we have been used to in the past."

Effectiveness testing

One of the most difficult issues to deal with over the years has been hedge effectiveness testing. To be able to use hedge accounting under IAS 39, although IASB does not specify a method of calculating effectiveness, it does stipulate an effectiveness range – a so-called 'bright line' within which fair value must fall both prospectively and retrospectively – of between 80% and 125%. With IFRS 9 it is the duty of the business to satisfy auditors that on a prospective basis all intended hedges will be effective. But instead of using arbitrary accounting metrics, it can use information produced internally for risk management purposes. Lloyd believes that this less-prescriptive, more economic model should reduce the costs of implementation compared with those for IAS 39. However, it places the onus on the entity to establish prospectively that there is a sound economic relationship between each asset/liability and its hedge that will provide offset of risk. Failure to continue to do so would result in hedge accounting ceasing for that particular hedge relationship so any volatility experienced for that hedge would then hit the P&L.

What changing to IFRS 9 means

For those using IAS 39 or any similar GAAP model, the initial move to IFRS 9 hedge accounting may be seen as yet another issue to overcome. "Some people think hedge accounting is too hard. But put it into perspective; every entity will look at the amount of hedging it does and decide whether it is worth the effort or not," says Lloyd.

Where US GAAP and IAS 39 hedge accounting had many similarities, IFRS 9 is quite different, notes Wilson, adding that this may create "quite a headache" for global companies who must incorporate disparate GAAP requirements across their various jurisdictions. Lloyd however notes that even where there are differences, hedge accounting is "ultimately a choice". For Umbricht, the switch from IAS 39 to IFRS 9 signals no major operational undertaking. However, he reserves concern for the UK and Republic of Ireland where changes in local GAAP for statutory accounts will increasingly resemble IFRS rules. Companies in the UK and Ireland will need to move quickly to adapt to the new financial reporting framework, which will impose changes to the format of the financial statements and the disclosures required, becoming effective on 1st January 2015.

Lloyd argues that the shift to IFRS 9 represents more opportunity to engage in "finely-tuned" hedge accounting. US GAAP constituents were even encouraged to (and actively did) take part in the consultation period and she believes there may be convergence in time. Until then, businesses may even be "pleasantly surprised" to find that things that weren't possible before "could now be possible".

Many of the changes will enable companies to address some of the areas where IAS 39 was causing a "misalignment of accounting with common risk management strategies", says Farrar. It offers "friendlier accounting" for commodity risk managers, and being able to have derivatives as hedged items will also give companies more flexibility in how they designate hedge relationships. It will also enable them to "avoid some of the problems they have been having with derivatives with non-zero fair values" when going into hedge relationships.

The concluding observations from Wilson on the complexities of hedge accounting and the way in which the rules are changing are impressively forthright. "Businesses changed the way they were hedging economically to make it easier to do the accounting, and that's not a great situation," he states. "I don't think the standard-setters wanted firms to do that; they want businesses to manage their risk the best way they feel they need to, and for the accounting to reflect that. With IAS 39, we've often got the tail wagging the dog, with the accounting driving the economic hedging." Notwithstanding his reservations on the divergence between the likes of US GAAP and IFRS 9, he feels the new international standard for hedge accounting will address most issues by re-aligning accounting with risk management and, on the whole, "gets it right". ■

CORPORATE FINANCE

Successful SCF programmes

Supply chain finance (SCF) programmes offer suppliers numerous benefits, including the opportunity to significantly reduce their cost of borrowing. The benefits for buyers are also numerous, including increased payment terms and improved supplier loyalty. But what options are available to Asian companies interested in a SCF solution? And what do they need to know to make their SCF programme a success?

INSIGHT & ANALYSIS

Operating in a low yield environment

The current low-yield environment presents both opportunities and threats to treasurers in Asia. With the returns on many fixed-income instruments at a paltry level compared with a decade ago, the landscape has changed for the treasury department looking to manage its cash. We examine the options open to treasurers and question whether further changes to investment policy will be required.

CHINA PRACTICE

China's capital account deregulation

With the world looking on, Chinese authorities have taken significant steps in recent years to liberalise the RMB. The next move is the gradual opening up of the country's capital account. Treasury Today Asia examines what this means, how it will happen, and why this will be key in increasing the number of cross-border cash flows to and from the country.

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

Dr James Allan, Head of Environment and Climate Change, Maplecroft; **Jim Bidwell**, Global Head of Documentary Trade Product Management, Barclays; **David Blair**, Managing Director, Acarate; **Eric Burroughs**, Editor FX Buzz, Reuters News; **Enrico Camerinelli**, Senior Analyst, Aite Group; **André Casterman**, Head of Global Strategy and Business Development in the Corporate and Trade Markets, SWIFT; **Chris Devonshire-Ellis**, Chairman of Dezan Shira and Associates; **Mike Edwards**, Head of Solution Packaging and Communications, GTS, EMEA Bank of America Merrill Lynch; **Ian Farrar**, Partner and Corporate Treasury Leader, Accounting Consulting Services, PwC China & Hong Kong; **Jim Foley**, Managing Director, Citi Treasury and Trade Solutions, Thailand; **Dan Gill**, Senior Vice President, Weiland Corporate Solutions, Fiserv; **Damian Glendinning**, Corporate Treasurer, Lenovo; **Peter Höppe**, Head Geo Risks Research/Corporate Climate Centre, Munich Re; **Paul Lahiff**, Chairman, The New Payments Platform Steering Committee; **Shen Lee**, Senior Manager and Commodities Specialist in Corporate Treasury Services, Deloitte; **Wang Ming**, Director, Shanghai Yaozhi Asset Management; **Dino Nicolaides**, Director, Head of Treasury Advisory Services in Banking and Capital Markets, Deloitte; **Hugo Parry-Wingfield**, EMEA Head of Liquidity Product, HSBC Global Asset Management; **Stephen Peters**, Vice-President, Clear2Pay; **Sue Lloyd**, IASB Board Member; **Vairavan Ramanthan**, Director, eCommerce and Channels, Asia Pacific, Bank of America Merrill Lynch; **Gourang Shah**, Managing Director, Citi Treasury and Trade Solutions, Singapore; **Gary Slawther**, Corporate Treasurer, OCTAL; **Tim Summers**, Consulting Principal, XTEChina; **Chris Sutherland**, Treasurer, Transpower; **Jarno Timmerman**, Head of Treasury South East Asia Pacific, AkzoNobel; **Yann Umbricht**, Partner and Treasury UK Leader, PwC; **K. Waninda**, Vice President Finance, PTT Group; **Phil Weisberg**, Managing Director and Global Head of Foreign Exchange, Thomson Reuters; **Pierre Wernert**, Senior Consultant at Zanders Treasury and Finance Solutions; **Blaik Wilson**, Chairman, Reval Hedge Accounting Technical Taskforce; **Kee Joo Wong**, Head of Global Payments and Cash Management, HSBC Bank (China) Company Limited; **Peter Wong**, Founding Chairman, International Association of CFOs and Corporate Treasurers; **Yingying Xu**, Economist, Manufacturers Alliance for Productivity and Innovation; and **Wei Yao**, China Economist, Société Générale Corporate and Investment Banking.

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