PANDA BOND REFORM
A truly international debt capital market needs work

THINK BEFORE YOU SPEAK
Careful planning is essential to effective networking

HOW TO CONDUCT AN RFP
Tried and tested ways to get the best out of your banks

The Treasurer

THE MAGAZINE OF THE ASSOCIATION OF CORPORATE TREASURERS ◆ JULY/AUGUST 2016

PLUS

THE TOP TABLE
How treasurers can best make their stand in front of the main corporate board

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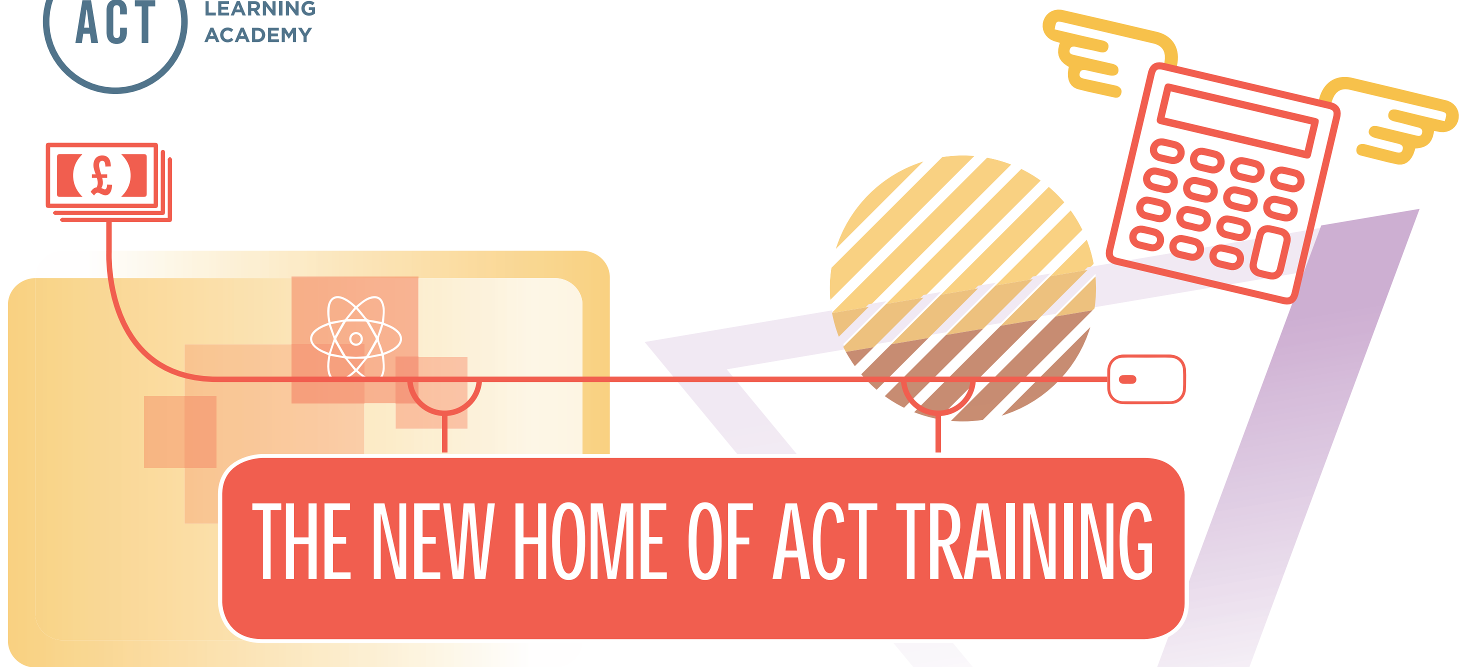
"For the business to recognise our contribution is very rewarding"

Shaun Kennedy, group treasurer at Affinity Water, on fundraising and job satisfaction



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LEADING TREASURY PROFESSIONALS

Editor's letter

As this issue of *The Treasurer* reaches you, Andrea Leadsom and Theresa May are the only remaining contenders for leadership of the UK Conservative party and British Prime Minister – the outcome of which won't ultimately be decided until 9 September. For the purposes of this leadership race, Stephen Crabb, Liam Fox and Michael Gove have become yesterday's men.

Meanwhile, prominent figures from all political parties in the UK, and both sides of the debate around Brexit, have proved only too eager to flee the stage. The Parliamentary Labour Party lost more than 20 members of the shadow cabinet in a week, while prominent Leave campaigners Boris Johnson and Nigel Farage both made waves with their shock withdrawals – the former from the Tory party leadership race and the latter as leader of UKIP.

If only businesses and corporate treasurers were in a position to leave the podium and put decision-making on hold over the summer recess. But plans, responses and 'what ifs' need to be addressed. Boards will need their treasurers' perspective more than ever. The ability to plan and provide an assessment on internal and external resources needed to weather the uncertainty in the short and medium term will be of primary importance, as will communicating the level of exposure implied in different courses of action, as Sarah Boyce, the ACT's policy and technical team's associate director, describes on page 19.

Happily, executive boards are paying more and more attention to the positions and opinions that treasurers can deliver, as Sally Percy finds in her feature on page 24. Treasurers' perspectives on business strategy and risk management are now a key feature in boardroom discussions. And with so little in the way of firm ground on the political and economic fronts, we should expect treasurers' assessments of current volatility to be much sought after.

In or out of the EU, corporates need a secure understanding of privacy and data-protection laws and how they differ from one territory to the next. Detlev Gabel and Tim Hickman set the scene on legal requirements, on page 34. And on page 32, we look at how Chinese regulators and other market players can help open up the Panda bond market.

I hope you enjoy the issue.

Liz Loxton

editor@treasurers.org
Follow us on Twitter @thetreasurermag

THIS MONTH'S CONTRIBUTORS

Sally Percy is a business and finance journalist. A former editor of *Accountancy* and *The Treasurer* magazines, she now runs her own content agency, Love Letters Publishing, which specialises in providing written content for financial services businesses. Follow her on Twitter @SallyPercy and read her feature on boardroom reporting, on **page 24**

Andrew Burgess is an experienced treasury professional working for GE Alstom near Zürich, and is the ACT's regional organiser for Switzerland due to an overactive volunteering reflex. Andrew has written several articles for *The Treasurer*, has spoken at ACT events and can highly recommend both. His feature on RFPs is on **page 28**

Darryl Howes is a learning and development consultant with a focus on employability and career management. He has a special interest in psychology, behavioural science and the role that influence and persuasion play in our working lives. He is a visiting lecturer at City University and writes about networking on **page 42**

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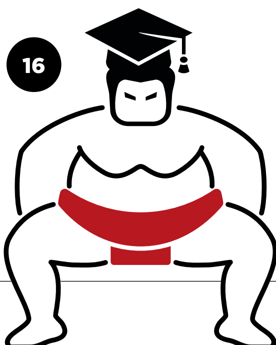

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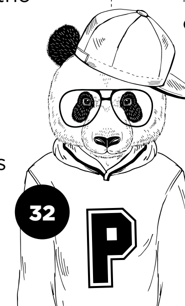

Agenda

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SHUTTERSTOCK

{ BREXIT }

TREASURERS ACT WITH CAUTION IN THE WAKE OF BREXIT

Members voting in an ACT poll conducted one week after the referendum have named FX volatility and currency weakness as their primary concern in the wake of the UK's vote to leave the EU.

Some treasurers reported avoiding FX trading as far as possible, in the days following the Brexit result. However, of those corporates who have had to carry out trades, the picture has been not as restrictive as expected. One treasurer said: "Although it has certainly been more challenging in that some banks have found it easier to price than others, it has not been impossible, by any means."

In a separate ACT poll conducted one week before the vote, 26% of respondents said they had extended their FX hedging, either by increasing the percentage hedged or covering further forward.

However, with sterling moving around 10% lower against most major currencies, businesses with balance-sheet hedges can expect correspondingly large moves in their mark-to-market values with potentially adverse impacts on liquidity. "My suspicion is that some corporates are facing large margin calls. If you've a synthetic dollar liability for instance, then a 10% move might mean a considerable collateral liability and a tense conversation with your bank," said another treasurer.

The prospect of interest-rate cuts, signalled by Bank of England governor Mark Carney in a speech on 30 June, raises issues for corporates holding abundant surplus cash, notably the need to build a plan for a world where short-term deposits earn very low or no positive return. It also presents challenges for treasurers with pension management responsibilities. As one treasurer said: "The biggest immediate impact comes when you calculate the pension deficit."

WORDS

"In my view, and I am not prejudging the views of the other independent Monetary Policy Committee members, the economic outlook has deteriorated and some monetary policy easing will likely be required over the summer."

Mark Carney's (pictured above) forward guidance a week after Britain voted to leave the EU.

SOURCE: *THE GUARDIAN*, 30 JUNE 2016

{ BREXIT }

Resource issues loom to the foreground in post-Brexit UK

Uncertainty over the UK's continued ability to access the EU as an export market for financial services and the free movement of people for employment purposes is raising fundamental resource questions for UK-based treasurers.

Since the UK referendum vote to leave the EU, doubts as to the UK's continued entitlement to export and import financial services under the so-called passporting rules have been much debated in the business press and by politicians.

Passporting enables authorised firms operating in the European Economic Area (EEA) to market financial services across borders and is being seen as the aspect of Brexit with greatest potential to disrupt UK- and foreign-owned multinationals, and their ability to operate from within the UK.

With political parties in considerable disarray at the time *The Treasurer* went to press, clarity over a firm UK negotiating stance in relation to financial services passporting was lacking. For treasurers, many of whom make use of services from banks based on the continent or with centralised treasury operations outside the UK, but within the EEA, that poses a significant obstacle to the task of drawing up contingency plans.

"Some treasuries are concerned about the impact Brexit could have on their teams, as many are made up of highly qualified workers from the EU. Uncertainty around the future of what will happen to EU workers already in the UK could unsettle teams and could impact on recruitment decisions," said one treasurer.

"From a corporate treasury perspective, in terms of resources, I could see some cases where, if you have a treasury centre on the continent with a number of UK expats working in it, it may not be practical for those people to continue in those roles," said Hugh Davies, director at Zanders Treasury and Finance Solutions.

"There needs to be a really clear new framework for how business engages with government. We're a long way off having a plan and real leadership. This is what business really needs."

Carolyn Fairbairn, director-general of the Confederation of British Industry, seeks firmer ground on the government's way ahead for corporates, following the UK's vote to leave the EU.

SOURCE: *THE FINANCIAL TIMES*, 29 JUNE 2016

{ FINDINGS FROM THE 14TH EY *GLOBAL CAPITAL CONFIDENCE BAROMETER* }

50% of respondents expect to actively pursue acquisitions in the next 12 months

40% **intend to enter alliances to accelerate top- and bottom-line growth**

5x is the level of increased appetite for deals in the $1bn to $5bn range

74% **are considering cross-border investments**

37% expect distressed asset sales to become more significant

SHUTTERSTOCK

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"It must and will make a noticeable difference whether a country wants to be a member of the family of the European Union or not. Whoever wants to leave this family can't expect to do away with all of its responsibilities while keeping the privileges."

German Chancellor Angela Merkel stands firm on the conditions under which Britain might gain access to the EU's internal market.

SOURCE: REUTERS, 28 JUNE 2016

{ CONTEXT OF TREASURY }

M&A deals fall in UK while value increases, ONS finds

The UK's Office for National Statistics (ONS) has found a sharp increase in the value of domestic M&A transactions during Q1 2016, compared with the previous quarter.

The total value of domestic M&A deals for Q1 this year was £11.6bn, the highest value reported since Q4 2008, which saw totals of £18.2bn. During Q1, dealmakers brought 57 domestic M&A deals to a completion, while 29 foreign acquisitions of UK companies were concluded, down from 49 in Q4 2015.

The aggregate values for both types of deal increased significantly. The total value of domestic M&A for Q1 was £11.6bn, the highest aggregate value since 2008. Inward M&A for Q1 reached £49.4bn, up from £9.2bn in Q4 of last year and the highest level since Q2 2007.

Despite volatility from one quarter to the next, the total number of deals involving UK companies remains at historically low levels.

More broadly, CFO respondents to the EY *Global Capital Confidence Barometer* 2016, say they expect the global M&A market to improve over the next 12 months. Some 54% of CFOs from developed markets expect to actively pursue acquisitions over the course of the next year, versus 39% of emerging-market CFOs, according to the study.

The survey also found that 39% of developed-market CFOs are looking to hire new talent, compared with 21% of emerging-market CFOs.

{ NEWS FROM THE ACT }

Resources from the ACT

The ACT has posted Brexit-related material online and will be making further information, guidance and advice on the implications of the vote to leave the EU available via the ACT website at www.treasurers.org/brexit

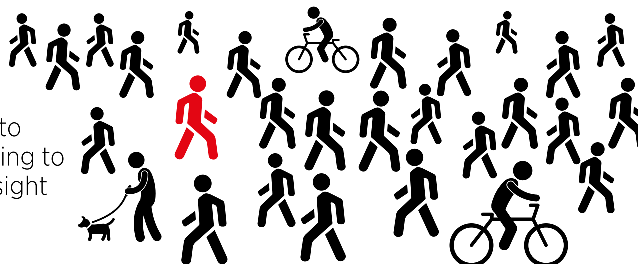
The ACT is expanding its means of engaging with members by establishing a number of special interest groups – small groups of members with common interests in topics such as cash management. The groups will review market and regulatory developments with a view to briefing other members and responding to trade associations, regulators and other interested parties on behalf of the membership. Invitations plus information on these new groups will be posted on the ACT website.

167 – the number of supercomputers located in China, out of a worldwide total of 500

¥145bn – the expected loss at Mitsubishi Motors after admissions by the carmaker that it had falsified emissions testing for more than 25 years

£1,840 – the rental cost per month of a two-bed furnished flat in Sydney compared with £4,750, cost of a two-bed furnished flat in Hong Kong, according to consultancy Mercer's cost of living survey

One in 29 – the proportion of Londoners who claim to be millionaires, according to consultancy WealthInsight and *Spear's* magazine



$4.7bn – the amount tech firm Symantec has said it will pay for Blue Coat, a cybersecurity firm that specialises in blocking attacks

$15m – the amount Starbucks has paid in UK corporation tax since setting up a London HQ, following public outcry over its low contributions

{ CONTEXT OF TREASURY }

IMF says China must tackle its corporate debt

The International Monetary Fund (IMF) has warned that China's need to tackle its levels of corporate debt is now pressing, if it is to avoid deepening economic problems.

In a speech last month in Shenzhen, first deputy director David Lipton said the country's ongoing problems with non-performing loans (NPLs) puts it at odds with the IMF's recent decision to include the renminbi in its basket of reserve currencies.

While acknowledging China's moderate success in moving from an investment phase towards an economy based on consumption, Lipton criticised the government's more limited progress on corporate debt.

Lipton pointed out that total debt in China is equal to about 225% of GDP. Of that, government debt represents about 40%, while households account for a similar proportion. By international standards, he said, neither of those burdens are particularly high.

However, corporate debt is a different issue. China's approximate level of corporate debt stands at around 145% of GDP, which Lipton described as "very high by any measure".

By IMF calculations, Lipton noted, state-owned enterprises (SOEs) account for about 55% of corporate debt – far greater than their 22% share of economic output.

"[SOEs] are also far less profitable than private enterprises," he said. "In a setting of slower economic growth, the combination of declining earnings and rising indebtedness is undermining the ability of companies to pay suppliers or service their debts."

He added: "The past year's credit boom is just extending the problem. Already, many SOEs are essentially on life support. [Our] most recent *Global Financial Stability Report* estimated that the potential losses for Chinese banks' corporate loan portfolios could be equal to about 7% of GDP.

"This is a conservative estimate based on certain assumptions about bad-loan recoveries and excluding potential problem exposures in the 'shadow banking' sector."

{ OLIVER WYMAN'S *WOMEN IN FINANCIAL SERVICES 2016* RESULTS }

20% – level of female representation on the boards of financial services companies

16% – **female representation at executive committee level in financial services**

32 years – the time it will take at current rates of growth for female representation on executive committees to reach 30%

33% – **executive committee members in financial services in Norway who are women**

20-30% higher – the attrition rate among female managers, senior managers and executives compared with peers in other sectors

{ AROUND THE WORLD IN 30 DAYS }

ITALY BANKS, LSE-DB MERGER, BANKERS ON BREXIT

Italy bids for bank bailout

Italy's prime minister, Matteo Renzi, put a full-scale restructuring for his country's beleaguered banks on the EU table for discussion. According to reports, Renzi has sought agreement for a €40bn plan that would allow Italy to inject capital into a banking sector weighed down by around €200bn in delinquent debts and bring about the kind of recapitalisation that other European countries undertook in the wake of the 2008 financial crisis.

But the move runs counter to the trend post-2008 away from taxpayer-funded bailouts in favour of creditor-funded bail-ins and would require a waiver of the EU's Bank Resolution and Recovery Directive.

Italian prime minister, Matteo Renzi

PHOTO BY 360B/SHUTTERSTOCK

London and Frankfurt merger doubts

In further fallout following the Brexit vote, the head of Germany's financial regulator cast doubt on whether London could host the headquarters of a merged London Stock Exchange and Deutsche Boerse.

Felix Hufeld said it was hard to imagine how the biggest exchange venue in the eurozone could be steered from outside the EU or provide a base for its euro-based clearing business. He went on to suggest that euro clearing could be processed in Frankfurt. At the time of writing, the management teams of both exchanges believed the merger itself would still go ahead even with the UK outside the EU.

Central bankers put heads together over Brexit

The heads of the UK and US central banks, Mark Carney and Janet Yellen, excused themselves from the European Central Bank's annual economics conference to confer in the wake of the UK referendum result.

Following the success of the 'Leave' voters and a sell-off across international financial markets, Carney cancelled his ticket to the Lisbon event in favour of staying in the UK and Yellen returned to the US. In the aftermath of the referendum, which included sharp falls in sterling, sell-offs in bank stocks and downgrading in the UK's rating from the three main agencies, Carney faced criticism about his pro-Remain stance from prominent campaigners.

The Bank of England said in a statement that both the bank and its governor were focused on shoring up financial and price stability.

Rio's financial black hole

Brazil's financial woes have led the state of Rio de Janeiro to declare that it is on the brink of 'public calamity', a statement intended to trigger central government aid. Acting governor Francisco Dornelles said the state's financial woes will affect its ability to support the Olympic Games in August. The money shortages stem from a decline in tax revenues brought about by falling royalties from oil and recession in Brazil.

Rio de Janeiro, Brazil

India to announce successor at central bank

Two former deputy governors at India's central bank are the frontrunners for the top role due to be announced this month.

Prime minister Narendra Modi is expected to appoint a successor to Raghuram Rajan later this month. Rajan's surprise departure came in June, when he announced he was not seeking a second term and would return to his academic career. The two main contenders are Subir Gokarn and Rakesh Mohan, according to a central bank official.

German court rules on bond schemes

Germany's highest court has rejected a case against a landmark bond-buying programme, declaring it to be constitutional.

The Constitutional Court in Karlsruhe rejected a challenge to the European Central Bank's (ECB's) emergency bond-buying scheme that asserted the Outright Monetary Transactions (OMTs) were effectively state aid. OMTs were conceived by the ECB to shore up the euro and give the bank broad powers to buy the debt of financially strained members.

The court has endorsed the OMTs, which have yet to be used, but has placed some limits on Germany's participation in the scheme.

Abu Dhabi banks to merge

National Bank of Abu Dhabi (NBAD) and First Gulf Bank confirmed that they are discussing a potential merger to create one of the largest banks in the Middle East and Africa.

More consolidation within the region's banks could follow. The UAE banking sector has more than 50 banks and has been hit by lower government spending and falling oil prices, which have taken their toll on deposits.

NBAD shares rose 15% on the day of the announcement and other banking stocks also saw increases. Local investors welcomed the news, but analyst response was muted.

{ CONTEXT OF TREASURY }

Industry bodies say Basel risk rules will hinder corporates

Basel Committee plans to alter banks' internal risk frameworks could backfire and restrict financial services available to corporate clients.

That's according to the International Swaps and Derivatives Association (ISDA), which has drawn up a joint response to the proposed measures with three other, heavyweight industry groups: the Global Financial Markets Association (GFMA), the International Association of Credit Portfolio Managers (IACPM) and the Japan Financial Markets Council (JFMC).

Outlined in a March consultation document, the Basel Committee's changes would strip banks of the option to use internal risk-based (IRB) methods for calculating capital requirements for credit-risk exposures. In particular, the committee aims to rein in variability in risk-weighted assets (RWAs). However, in their response, the groups argue that a host of key, corporate lifelines – from project finance deals to aircraft, shipping and commodities finance – would be drastically affected.

The committee's March consultation paper outlined proposals to remove the option that banks currently have to use IRB approaches for certain risk exposures, in cases where the parameters cannot be estimated with sufficient reliability for regulatory capital purposes; enforce exposure-level, model-parameter floors, to ensure minimum levels of conservatism for portfolios where IRB approaches remain available, and reduce variability in RWA; also for portfolios where the IRB approaches remain available.

A joint response from ISDA, IACPM and JFMC criticises the objectives, arguing the measures represent a "major step backwards".

"The removal of risk sensitivity," explained the response, "will distort capital allocation decisions, origination incentives and pricing to the detriment of banks' customers and the global economy."

In particular, it warned: "Corporates are likely to suffer restrictions on the availability of many banking services and products needed to support their commercial activities and hedge financial risks. Corporate lending, capital markets activity, project finance deals, aircraft and shipping finance... will all be extremely affected by the proposals."

{ CONTEXT OF TREASURY }

SME FUNDING IN EUROPE

If Europe is serious about supporting jobs and growth, it requires deeper capital markets capable of funding smaller businesses.

That is the message from the former EU financial services commissioner Lord Hill in new London Stock Exchange report *1,000 Companies to Inspire Europe 2016*. Focusing on the SME landscape, the report examines firms that have collectively reached an average annual compound growth rate of 71%, while increasing their staff by 66% over the past two years.

The report notes that the top 100 companies on its list have grown by more than 400% over the past three years – yet in four decades, just one of the world's most successful start-ups has come from Europe, while 25% of them have emerged from California alone. In the report's view, European start-ups are saddled with the "short-term fix" of debt, while equity offers greater space for development and innovation. For Hill, work towards capital markets union is only the beginning of what Europe could do for its SMEs.

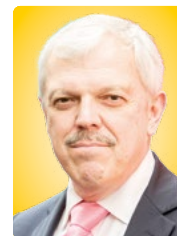
Lord Hill, who resigned his EU post in the wake of Brexit, wrote in the report: "if promising companies can't get financing in Europe, they will vote with their feet and look for it elsewhere", benefiting other regions.

Lord Hill

PHOTO: BLOOMBERG/GETTY IMAGES

CASH AND BENCHMARKS

As you will be aware, following the UK referendum, Brexit is a reality. There is much uncertainty and therefore highly volatile market conditions. The ACT will be taking the lead to ensure that regulators and policymakers understand the real economy requirements to ensure that growth can be delivered post Brexit. Also, as part of our remit is to provide informed and unbiased technical advice, we have provided a range of resources that can be accessed at www.treasurers.org



Steve Baseby is ACT associate policy and technical director @BasebyStephen

{ IN DEPTH }

CASH LOOKING LESS KINGLY

The first four decades of my career in finance were those when cash was king. Now substantially into my fifth decade, cash is a depreciating asset with yields sub-inflation as central bankers try to cajole us into spending: new cars; perhaps an entrepreneurial outburst; or an eye-wateringly expensive apartment.

The attack is multi-pronged. Negative rates have seeped out from the safe haven of Switzerland to the short end of the euro corporate bond market. We are in the extreme world, where processes and systems honed over the postwar decades may prove unable to cope. In some jurisdictions, interest legally can only go one way. Short-term debt is already being issued at a premium to par so that a positive coupon can be set.

Negative rates come with other problems. That bank loan you swapped into fixed rate no longer looks so straightforward because the Loan Market Association-documented bank loan has an interest floor you agreed when rates were always positive, while the International Swaps and Derivatives Association-documented swap does not.

Banks struggle to take your deposits in a world where they dare not hold spare capital,

and may soon be obliged to use your deposit to purchase government bonds because you efficiently gathered your cash in a treasury subsidiary sitting on a web of netting and pooling agreements. European Banking Authority guidelines heading for your EU-domiciled bank may soon require you to back the cash out of that subsidiary into a trading or holdco to get some yield because then the bank need only spend 40% of its value on government bonds.

The predictable tax outcome you may once have had by domiciling your payments factory in a convenient location is now being unwrapped by an Organisation for Economic Co-operation and Development-fuelled outbreak of cooperation among governments worldwide amid a rush to reduce corporate tax rates.

And why?

Classic Western economic policy dictates one can spend out of deflation into growth. The regulators of our old Western economies want you to get the cash into circulation: pay dividends, make share buybacks, lower prices, raise wages, fund the pension deficit, pay tax, pay down debt, invest.

The first two enable others to invest if they are any better than you at finding anything in which to invest. The next two may be anathema to your directors, who have survived several recessions and cling to any price and cost advantage they can. The next a 'perhaps' as we watch two old British businesses collapse under the burden of pension costs created by low yields. UK members will be asked to comment on our response to the Base Erosion and Profit Shifting initiative to get you to pay more tax. The next one would enable your bank to become even smaller or moves the problem onto your institutional debt investor. The last, well, you would have done that already if you could find anything worthwhile to invest in.

We do ask treasurers why they hold cash. Numerous clever minds at the Bank of England (http://tinyurl.com/jnono6s) have asked the same question. The reasons are manifold: continued mistrust of banks to be able to lend at the very crisis point at which you need to borrow; that potential acquisition you are always on the verge of funding; President Trump; French election; Chinese collapse; continued low growth; excess steel; Zika virus; and so on.

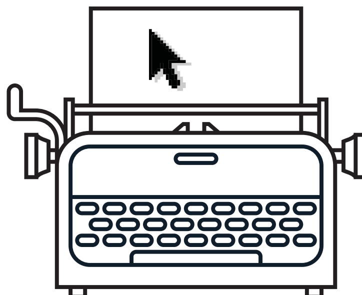
You could try repos to squeeze a better yield than deposits, but inflation still wipes out the yield. You might glance longingly at riskier banks and traded securities, but that approach tends to catch up with reality. We have to accept at least that even a small company takeover will not be agreed in a couple of weeks, and put the cash out long enough, in deposit or repo, for a bank to be able to economically use it.

We are assembling a special interest group on cash and liquidity management to monitor, represent members to regulators, and inform.

If you would like to become a member of this group, please let us know by getting in touch via technical@treasurers.org

View the technical updates and policy submissions at www.treasurers.org/technical and www.treasurers.org/events/webinar

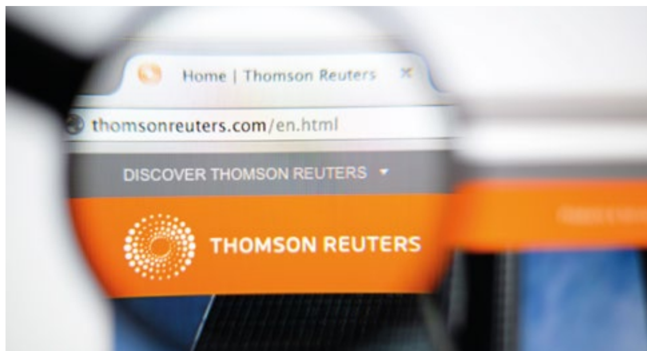
The policy and technical team has written various blogs this month at blogs.treasurers.org



{ INTERNATIONAL }

BENCHMARK CHANGES

On 1 June, Thomson Reuters launched a new FX benchmark, the WM/Reuters 2pm Central Eastern Time (CET). This new benchmark is offered as an alternative to the European Central Bank's (ECB's) 2.15pm CET reference rates, which will be published at around 4pm CET from 1 July 2016. While the ECB reference rates will continue to be based on a point-in-time snapshot at 2.15pm CET, the change in publication time is to reinforce the distinction between exchange-rate fixings used for transaction purposes and the ECB reference rates that is intended for information purposes only.



The new WM/Reuters 2pm CET benchmark is available across 150+ currencies against the euro, pound sterling and US dollar as a subscription service. Corporates have free access to the benchmark for 32 currencies against the euro (those currently covered by the ECB reference rate) with a half-hour delay.

As a reminder of changes to benchmark legislation and methodologies, in *The Treasurer* (June 2016) we mentioned that the EU Parliament passed legislation on benchmarks such as the Euro Interbank Offered Rate and Libor to make them more reliable and to remove the conflicts of interest identified in previous means of setting interest rates. (See http://tinyurl.com/h3kj6n5)

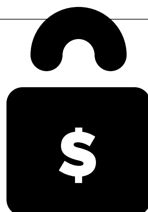
{ WATCH THIS SPACE }

Sanctions

Sanctions move to the fore as governments become more concerned about funds routing to terrorists. This is why your KYC has become exhaustive and exhausting.

It also becomes frustrating when your government claims a country is open for business while the Treasury will not allow funds to go there. And that includes the US Treasury if you are trying to make forex payments, because most would go through the US dollar and therefore a US dollar bank account.

For treasurers, the concern is that banks will want your business to represent it complies: in new debt agreements; renewable agreements (euro medium-term note, facility extensions); and ongoing agreements, such as that CP Trust Deed and Issuing and Paying Agency Agreement you wrote years ago.



The negative representation is difficult except in any but the smallest business operating locally. Resist being asked to make the representation that you have no sanctions breaking activity – because you cannot know what every employee and customer is doing everywhere, all the time. The positive representation is more comfortable and achievable: to seek not to break sanctions and to conform with those laws applicable to your business and transactions.

Also, it is essential now to ensure your relationship manager has the full business story to take to his or her compliance team and, of course, your governance story to show why the positive representation is valid.

{ TECHNICAL ROUND-UP }

Tax relief on interest – UK BEPS next steps and US earnings stripping rules

The UK Budget sets the cap on interest deductions at 30% of tax-calculated EBITDA. Further detail has been issued as a consultation, which is open until 4 August 2016, and the policy and technical team will be putting together a response. If you would like to comment on the ACT response or raise any specific comments you may have, please contact technical@treasurers.org

The US has announced new earnings stripping rules intended to dissuade inversion transactions. However, they have the consequence of discriminating against non-US-owned multinationals, who use debt-funded dividends to maintain an appropriate debt-equity ratio in US businesses. This debt will be treated as equity and is therefore not tax deductible.

MMF regulation – time to update your investment policies?

EU re-regulation of money market funds (MMFs) is likely to finalise later this year. Current leaning is towards low volatility net asset value and variable net asset value (VNAV) MMFs for corporates with credit ratings. Redemption gates and fees are expected.

Meanwhile, in the US, the Securities and Exchange Commission rules will take effect in October. These rules require that funds switch to a VNAV from the constant, $1-a-share value that the majority of funds historically used constant NAV. The new rules also require that funds introduce redemption fees and other redemption controls if a fund's weekly liquidity falls below 30%. Treasurers need to revisit their investment policies to ensure boards understand the capital risk and redemption uncertainty, and want to continue to use MMFs.

ECB quantitative easing – corporate bond purchases

The European Central Bank (ECB) has purchased more than €1 trillion of government bonds, and from 8 June has diversified into buying qualifying investment-grade euro-denominated bonds issued by non-bank corporations established in the euro area.

Further details of eligibility and FAQs can be found on the ECB website.

KATARZYNA PIWOWARSKA

CORPORATE FUNDING MANAGER AT EUROCASH GROUP – A WHOLESALE DISTRIBUTOR IN POLAND

How did you get into treasury?
After I graduated from university, I applied for a management trainee programme at my current employer. During my first months, I undertook training secondments within various departments of the enterprise. Once I came across the treasury department, I realised that this was the most interesting area for me.

What do you like about treasury?
Every day brings something new: some brand new challenges, new people, new market environments. It provides huge opportunities for my personal growth. Moreover, working in treasury gives me a sense of having a real impact on my company's development. And that motivates me a lot.

What's the most unusual responsibility that you have as a treasurer?
All of them are unusual. My family perceives being a treasurer in rather a simple way: as me sitting in a room full of golden coins and counting them. And I have to say that, in a sense, I find that to be true...

What's the most important lesson that you've learned during your career?
Do not accept half measures and output that contains errors – even minor ones. Small shortcomings may lead to bigger issues, which may then turn out to be irremediable.

What's your ultimate career goal?
To become a corporate treasurer.

If you weren't in treasury, what would you do and why?
I would probably be a gardener due to my admiration of nature.

+ If you would like to star in our 60-second interview slot, email editor@treasurers.org. Please provide a photo of yourself, your email address and telephone number. We won't publish your details – it's just so we can contact you in the event of queries.

TRAINING, EVENTS & WEBINARS

TRAINING COURSE DATES

13 September, London
Treasury in a day
An introduction aimed at anyone new to treasury, looking to broaden their understanding of the function or improve their ability to have better conversations with management, operations, banks or treasurers as customers. You will learn about the role of a treasurer, and be introduced to key treasury concepts and financial instruments commonly used.

14 September, London
Working capital optimisation
Understand why working capital management is vital for the generation of sustainable cash flow and survival of all companies. You will gain an appreciation of the techniques that can be employed to manage working capital and improve efficiencies within the supply chain.

15 September, London
Cash forecasting fundamentals
On this interactive course you will learn how to review or completely redesign your cash forecast framework and processes. Don't miss this great opportunity to broaden your understanding of the fundamentals of cash forecasting.

20-21 September, London
Treasury systems
Find out how to identify treasury technology needs and select and implement the required treasury management system.

+ To view more courses or to book online, visit www.treasurers.org/training. For more information, contact Radmila Trkulja at rtrkulja@treasurers.org or call +44 (0)20 7847 2573

ACT EVENTS

18 August, Nairobi, Kenya
Upscaling infrastructure, technology and enterprise
We are proud to launch our inaugural conference in Africa. Designed for the regional treasury community – doing business locally and globally – this programme devotes time and high-quality discussion on how treasury professionals can drive growth for their businesses and for the real economy across the region.
www.treasurers.org/africa2016

21 September, Hong Kong
Asia Treasury Leaders' Forum
Join more than 200 treasury and finance professionals from across Asia to discover the latest developments in treasury tools, tactics and strategy. As the only conference of its kind in the region to bring together working treasurers, experts from the financial services industry, policymakers and the Hong Kong Monetary Authority, it is the perfect meeting place to share knowledge and best practice, and build your professional network.
www.treasurers.org/asia2016

4 October, London, UK
Technology Risk and Smart Treasury Forum
The ACT's launch event focused on the impact of new technology on treasury strategy and risk. An afternoon of strategic conversations about how changes in technology are driving changes in relationships with customers, supply chain, banks, treasury management system providers, C-suite, enterprise-wide link-up, teams and talent. Through a series of high-level roundtables, a group of senior finance professionals will meet to gain an overview of, and a voice in, the strategic risks and opportunities in an increasingly digitised business environment.
www.treasurers.org/technology

24-25 October, Dubai
ACT Middle East Annual Summit
Now in its seventh year, the ACT Middle East Annual Summit is the largest and most popular treasury event in the Gulf Cooperation Council. Uniting the region's leading corporates, you can expect to meet more than 450 treasury and finance professionals, hear from over 40 speakers, and talk business with more than 20 leading product and service providers.
www.treasurers.org/middleeastannualsummit

9 November, London, UK
ACT Treasury Forum
In partnership with HSBC, through a combination of keynotes, panel discussions and roundtables, delegates will discuss the impacts of political risk and technological evolution to consider how the form and size of the treasurer's world is changing and what that means for business. This is an invitation-only event for senior corporate treasurers.
www.treasurers.org/treasuryforum

9 November, London
ACT Annual Dinner 2016
With more than 1,400 guests, the ACT Annual Dinner is a firm favourite with key members of the finance community and friends of the ACT. Join us for an evening of excellent food, fine wine and good company.
www.treasurers.org/annualdinner

22 November, London, UK
ACT Working Capital Conference
Efficient and careful management of working capital is crucial to the survival and growth of businesses, and this conference will delve into current trends, best practice and industry-specific case studies. Join us to get a broad and holistic view of managing your working capital.
www.treasurers.org/workingcapital

ACT WEBINARS

Join in the discussion and debate from the comfort of your desk
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+ To attend an ACT webinar, book online at www.treasurers.org/events. For more information, email events@treasurers.org or call +44 (0)20 7847 2589

{ INTEREST RATES }

JEREMY WARNER

If ageing populations are one of the drivers behind historically low interest rates, then it's hard to see a remedy

Back in 2010, Bill Gross, the so-called "king of the bond markets", proclaimed that UK government bonds were "resting on a bed of nitroglycerine" and predicted some kind of related asset price collapse. With the near-death experience of the financial crisis fresh in everyone's minds and the eurozone sovereign debt meltdown about to kick off, it was easy to see why he said what he did.

Britain had one of the largest budget and current account deficits in Europe and its creditworthiness as a nation was being widely questioned. As it turned out, Gross could scarcely have been more wrong. Since then, gilt yields – which move in inverse proportion to prices – have gone down and down, hitting historic lows just recently. And it is not just Britain. Elsewhere, the decline in yields has been even more extreme. The yield on German 10-year bunds has sunk to virtually zero, while Japanese 15-year money has slumped into negative territory. Worldwide, there are reckoned to be more than $10 trillion worth of government bonds trading on a negative interest rate, with many corporate bonds, too now joining the sub-zero club. Never before in history have governments, or creditworthy corporations, been able to borrow so cheaply.

In part, these ultra-low rates are the result of central bank money printing. Britain and the US ceased their bond-buying programmes (quantitative easing) some time ago, but asset purchases continue apace in the eurozone and in Japan. If bond yields are being driven to zero in these regions, then investors look for higher yielding 'risk-free' assets elsewhere, so UK and US yields fall, too.

Yet unconventional monetary policy is as much a consequence of the low interest-rate environment as a cause; there is a deeper, underlying reason – the so-called 'savings glut'. Central banks are in truth only responding to a broader market-based fall in rates, forcing them to reduce official interest rates to zero and beyond in order to provide stimulus.

The cautionary effects of the financial crisis provide a partial explanation for risk aversion

On a global basis, corporations and households are saving their earnings rather than investing and spending them, creating a self-fulfilling climate of low demand and poor growth. Growing risk aversion forces this excess of savings into supposedly risk-free assets such as US Treasuries, German bunds and even UK gilts. None of these securities is at all likely to default, if only because in extremis they can all be serviced through central bank money printing. Investors are all but guaranteed their money back, yet in chasing these assets, investment in productive growth grinds to a halt.

The cautionary effects of the financial crisis provide a partial explanation for risk aversion. In time, this ought to pass. Yet, unfortunately, there is also a rather more pervasive and therefore worrying one: demographics. As societies age, they save more to support themselves in retirement, and they spend and invest less freely. Eventually, there will come a tipping point, when retirees will want to draw down their savings rather than add to them, but that may still be some distance off.

In any case, today's negative interest-rate environment is having some perverse consequences, creating new bubbles in a number of other asset classes such as housing. There is also some evidence to suggest that wafer-thin returns are causing companies and households to save even more, thus further crimping consumption and investment. More worrying still, the further yields erode, the greater the risks of catastrophic loss should prices correct and yields rise sharply again, as one day they inevitably will.

Policymakers seem to have run out of road. It's hard to see how this low interest-rate environment ends, except badly.

Jeremy Warner is assistant editor of ***The Daily Telegraph*** and one of Britain's leading business and economics commentators

LEARNING
ACADEMY

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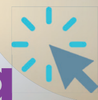
ACT Learning Academy - the official study centre of the Chartered body for treasury, the Association of Corporate Treasurers (ACT).



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academy.treasurers.org

Lessons to be learnt in Europe from Japan

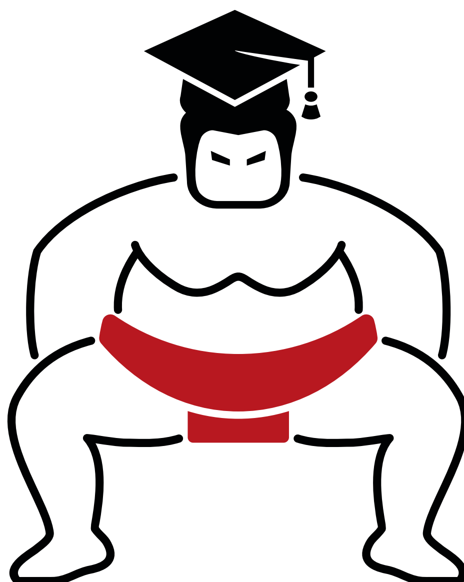
With debt running ragged and growth virtually at zero, improvement seems a remote prospect for the Japanese economy

When prime minister Shinzō Abe began his second term in December 2012, he introduced a policy strategy with 'three arrows' to kick-start Japan's stalled economic engine. The first two arrows, aggressive monetary policy and fiscal injections, began immediately. Early signs were promising as the boost to demand temporarily lifted growth and inflation. But the third arrow, supply-side reform, has been woefully lacking. As a result, the Japanese economy is stalling again. European economies have much to learn from the Japanese policy experiment. Without proper economic reform, costly stimulus programmes will not lead to faster growth in the long term.

In Japan, interest-rate cuts and large-scale purchases of government bonds by the central bank combined with government spending following the infrastructure that was damaged in the 2011 earthquake lifted growth and inflation during 2013. But in an attempt to address the piling debt and the enormous public deficit, Abe raised the rate of VAT to 8% from 5% in April 2014. This had an immediate negative effect, prompting two subsequent quarters of negative growth.

To offset an appreciating yen and in a further attempt to boost growth, the central bank then eased again by widening its purchases to further asset classes. More recently, the Bank of Japan joined the European Central Bank (ECB) and set a negative policy rate. But despite ultra-easy monetary policy, the economy has slipped back into deflation and total real GDP remains about the same size as it was in 2008. Why? The problems of the Japanese economy are not monetary in nature. Further easing will not lift growth.

One of Japan's key problems lies in its demographics: a shrinking labour force caused by an ageing and declining population. But demographic problems are hard to address in Japan. Even in Europe, which has a long history of cultural and ethnic variation, fears about the impact of migration are at the top of the public debate. For a country like Japan, whose history has been less shaped by migrants, the challenges are greater.



Japan faces a tough dilemma. While trend growth for real GDP is virtually zero, GDP per capita is rising as the population shrinks. Japanese citizens enjoy one of the highest standards of living in the world. But the level of public debt is unsustainable without a stronger trend rate of economic growth. Allowing more foreign workers to enter the Japanese labour force could provide the antidote. But as is often the case, the fixed-pie fallacy presents a big-policy obstacle.

The perception that total wealth is limited and must be shared out better is the false reasoning behind most attempts to prevent migration or redistribute incomes from the rich to the poor. There is no good reason why a properly managed economy cannot continue to grow and provide an improving standard of living for all its existing and new citizens. But for an economy like Japan, where the pie hasn't grown in almost a decade, overcoming this misconception is easier said than done.

Europe's major economies can indeed learn from Japan's economic quandary. Rising right-wing populism in core Europe reflects a frustration by its citizens that is rooted in the sluggish improvement in general living standards since the financial crisis. And while the ultra-aggressive policies of the Bank of England in the UK and the ECB policy in the eurozone have helped to lift Europe from the depths of recession, growth cannot accelerate further without proper economic reform. Inflexible labour markets in Italy and France, land and planning policies not fit for purpose in the UK and the reversal of some of the 2004 labour market reforms in Germany pose the major threats to long-term economic prosperity in these economies. The Japanese economy is where it is because the country has shied away from essential reforms for many years. There is no easy road out for Japan. For the UK and other European countries, Japan serves as an example of the problems ahead if they do not implement the necessary reforms to raise trend growth soon.

The Japanese economy is where it is because it has shied away from essential reforms for many years

Kallum Pickering is senior UK economist at Berenberg Bank

{ TREASURY INSIDER }

Time for a change

Treasury Insider is wholeheartedly embracing new opportunities. Outwardly at least...

A lot of key moments in my career have arisen as a result of unexpected conversations. Today was one such occasion. I was called into a meeting with the CFO and the HR director. "This must be serious," I thought. And not for the first time.

I was told that the team was in such good shape that I was to be released into a different role – an opportunity to head into a challenging business unit, initially on a special project, to develop my career more broadly. One of the divisions needs some fresh financial thinking, apparently, and I was the person to inject it. I had always suspected that this particular unit had gone native and I imagine I have been chosen because I am a good corporate citizen.

The powers that be are unclear how long this project role will last or where it's heading, but sometimes there's uncertainty in life – they told me. I went through the motions of asking whether this is a promotion and whether it's optional or not. The predictable response was: "No, but it will be career enhancing", followed.

At least I'm not being asked to run the shared service centre. And, of course, it does present the opportunity to go a little native myself (although not too much – that would be rather hypocritical). Perhaps it will be me asking for covenant-lite borrowing or being unhappy when the divisional hedge positions are out of the money?

SHUTTERSTOCK

I have to achieve a balance between my pride and reality

Of course, I will hopefully have a route back at some stage and I can certainly watch from a distance how my team develops without my guidance. They may even miss me – you never know.

It may also be the case that I have spent too long at corporate head office and that I ought to get out into the real world. If nothing else, I will see how the other half operates. Other than a short spell many years ago, I have spent very little time away from corporate HQ and I have learnt a great deal on the occasions that I have.

I spent a few days planning for the announcement and transition, to make sure there would be continuity for counterparties; they do matter. Overall, I have decided to approach this change of direction positively, even if there is a part of me that feels this is a boost to others' development as much as mine. I guess I have to achieve a balance between my sense of pride on the one hand and the realities of life as a finance leader on the other – even if there is an impact on my career aspirations.

After all, how bad can it be? I will be supporting a different manager, a respected non-finance CEO of a division I have often seen at conferences, with whom I need to have a good rapport. It's a chance to establish myself in a new area, while keeping the same disciplines of control, communication and competence that I have built up over the years.

There is the realisation that in my new role I will have to be taken seriously when it comes to funding requests, cash flows and forecasting, as well as the fact that others will probably have high expectations. I imagine that's natural and I mustn't grumble.

I believe that treasurers can adapt and operate in a number of roles. It is best not to be typecast. I hope the experience will make me stronger and I will stay in touch with the network and attend events, of course. However, I will miss day-to-day strategic treasury matters and being part of such an essential function – where cash, or access to it, is the lifeblood of the organisation and vital to its survival.

As someone once said: "I'll be back."

The Treasury Insider has led a corporate treasury function inside a well-known institution

ACT

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FREE FOR CORPORATE TREASURY TEAMS

SHUTTERSTOCK

Initial thoughts for corporate treasurers in the wake of the UK referendum result

The events of 23 June clearly surprised some more than others – and, as we all know, the one thing that markets hate is surprises… and this isn't a UK-only issue.

It is clear that it will take some considerable time for the political process and EU negotiations to be completed (or even provide any degree of clarity). But in the meantime, the wheels of the real economy must continue to turn, and so management teams – including treasurers – need to start planning and finding solutions as soon as possible.

From a treasurer's perspective, this stage of the process is all about planning, communication and disclosure. This is not the time for the treasurer to hide themselves away – they need to be involved in every Brexit conversation and party to all decisions. And they need to be looking both inwards and externally.

There is the internal angle: it is vitally important that the treasury team is fully embedded into the business, not only to provide support to those businesses that are having to adjust their strategic plans, but also to ensure that any planning includes the impact on financial risk and funding. For example, if the decision is made to restructure or relocate, this may have an impact on foreign currency exposures and local borrowing requirements. Given the high degree of uncertainty, chances are there'll be more than one plan, too… More prosaically, treasurers also need to revisit treasury policies and ensure that they still 'work' in the post-Brexit world and are being adhered to.

Then there is the external angle: strong and effective relationships with debt investors and relationship banks (the sources of finance and hedging) are critical. The high volatility in FX and interest-rate markets that has been present for several months is unlikely to fall in the short term and so, not only do treasurers need to manage their exposures carefully, they need to be able to explain to investors and other stakeholders the impact of this volatility on the financials.

So, initial thoughts for a treasurer might be:

- Sit down with the FD and management team, and understand the big picture internally. Consider carefully what disclosures are made to the markets;
- Talk to relationship banks, lenders and debt investors, and understand what they are thinking and what their worries are; and
- Talk to their legal advisers, particularly about continuity of contracts and covenant compliance.

Of course, all this talk of Brexit overlooks a few 'minor' points: even before the referendum there were building pressures from low (or even negative) interest rates; slowing growth in many parts of the world (not just the mature Western economies); changes in accounting rules and other regulation that will result in the grossing up of the balance sheet with the resulting impact on financial covenants, credit ratings, etc; increased bank regulation feeding through to the real economy; growing political instability – not just emanating from the Middle East, but also from the forthcoming US elections. As for the strains that were beginning to show in the eurozone, these have not been helped by the vote on 23 June.

To summarise, we are now in the Brexit planning phase – and need to be prepared to make many plans, safe in the knowledge that none of them will quite fit the bill when the time comes. But treasurers are excellent problem-solvers, so should relish the opportunity to really get stuck in.

The treasurer needs to be involved in every Brexit conversation and party to all decisions

The ACT published a number of articles and guides in the weeks leading up to the referendum and will continue to provide resources and support to our members and the wider financial community. These resources can be found at **www.treasurers.org/brexit**

Sarah Boyce is associate director in the ACT's policy and technical team

IN FULL FLOW

Shaun Kennedy, group treasurer at Affinity Water, talks leaks, bond issues and five-year reviews

Words: **Ben Poole** / Photography: **Will Amlot**

Like many postgraduates, Shaun Kennedy came out of university, Warwick and then Lancaster, with a grand plan – in his case to become a computer programmer.

And like many other tech aspirants at the time, his early ambitions fell victim to the dotcom crash of 2001, when he was made redundant from a job with a financial trading software company "along with a load of other people", he says.

Looking round for a temporary job, Kennedy started working at a housing association, Circle 33. "That's how I got my start in treasury," he explains. "It wasn't planned and I went in knowing very little about what treasury involved." The head of treasury, Nathan Dunton (now group treasurer at Virgin Atlantic), was leading a growing team, however, and proved to be a persuasive and supportive mentor. And there was a lot going on. As treasury officer to begin with, Kennedy gained experience of day-to-day cash-flow management. The organisation merged with Anglia Housing Group in 2005 and, by then treasury manager, Kennedy worked on debt and investment portfolios, banking relationships, intercompany lending and treasury accounting. He also began work on his ACT qualifications.

In 2006, he moved to Notting Hill Housing Trust as treasury manager. Again, this was an organisation in transition. The trust had been in difficulties with the regulator and had little in the way of treasury infrastructure. Kennedy built up the treasury function and, as well as finishing his AMCT there, he secured the trust's first credit rating with Moody's, issued its first capital markets bond for £180m in 2010 and a subsequent £120m tap a year later. He also set up the trust's first joint ventures.

At this point, having spent most of his career to date in housing, Kennedy realised it was time to do something different, so he joined SmartestEnergy, a subsidiary of Japanese multinational Marubeni and an independent electricity buyer. "It was a very different business to ones I'd worked in. Housing associations make a lot of long-term investments. SmartestEnergy was much more short term in its focus, so I'd gone from having loan facilities and debt stretching out 40 years ahead to an environment where loans were typically 18 months."

In it for the long term

While he enjoyed his two years at SmartestEnergy, Kennedy missed the capital markets work and the different interaction he'd had with banks in the housing sector. Seeking out a new opportunity with those characteristics led him to his current role at Affinity Water. He joined as group treasurer in 2013, a year after the utility's French owners, Veolia Water, sold the company to a group of infrastructure investors. His remit was to build up the treasury function of the now renamed water company.

Apart from some local cash management, most treasury work had previously been carried out centrally by Veolia's Paris head office. "It had a bond outstanding, but that was it. All the funding came from central intercompany sources," Kennedy says.

Today, the company has a whole business securitisation structure in place, similar to other water-industry players, such as Anglian and Thames. Soon after joining, Kennedy issued a number of bonds and refinanced bank debt. "I joined to manage what had been put in place, but also look to raise new debt in the future, raise other loan facilities. There was a huge process of setting everything up from scratch," he says.

A brush with regulation

Last year, the UK water industry's financial regulator finalised its latest five-year price-review process. Water companies submit their business plans to Ofwat, which looks at spending plans, measures them against an industry average for cost of capital and then sets limits to customer prices and revenues. It's an onerous process with reputations on the line. Affinity came out of the exercise with an 'enhanced status' rating – an endorsement of the company's engagement work with customers and its asset and financial management. But the pressure remains. "If we outperform in the next five years, the company gets to keep more of the over-performance. If it underperforms, the penalties are greater, so money goes back to the customer," says Kennedy.

Treasury has a direct link to the price-review process. The weighted average cost of capital that Ofwat looks for when it evaluates business plans is inextricably tied to the cost of equity and debt.

"Once bills are set, we are always looking to make sure we manage our debt well, but we also have a set cost of debt for the industry that you need to make sure you perform well against. Otherwise the costs will flow through to our shareholders directly. There's no way to pass on higher cost of debt. It gives treasury quite a high profile," he says.

One year into this asset management period and Affinity has some big numbers to chase. Like a lot of water companies, it's

replacing existing infrastructure. For Affinity, that represents a £500m investment for the period while also looking to improve water quality and encourage customers to use less water in a hard-pressed area.

"A large proportion of what we're spending this £500m on is what we call the water-saving programme, which includes water metering. We're metering 280,000 households over the next five years to reduce water use, to reduce demand," he says. Once a meter is installed, a householder has two years to change their habits if they're using too much water before they are moved to a metered bill, or they can switch to a metered tariff before this if they see a saving. "There's a big education piece that sits alongside the metering process: the South East is a water-stressed area. We have invested in new plants to ensure high water quality and a huge amount of new infrastructure to reduce leakage. If we can reduce leakage, we can extract less and leave more water in the environment, which is an important part of our plan."

Affinity has undertaken to reduce leaks by 14% over the next five years and has committed to a 5% reduction in the price its customers pay for their water.

Payments

Payments is an area where the treasury function comes close to its domestic customers. The public is far less traditional in its payment choices now, which means more digital payment methods are needed alongside the traditional ones. Direct debit is still very important, he says, but not all customers like it. Cheques, cash and Transcash still play their part, as well as payment apps like Pingit. Kennedy sits on the Payments Strategy Forums' end user working group, representing corporate treasurers (after accepting an invitation from the ACT) and keeps a close eye on developments. "There might be other new technologies that come along and there is a trade-off in terms of costs. We've also got to be mindful of people's preferences – we still accept cheques, for instance. And there's a huge amount of change coming in terms of cheque processing with digital imaging. It's been really interesting to get more involved in that."

VITAL STATISTICS

900 million
litres a day – average demand

1.1 billion
litres a day – peak demand

1.5 million
domestic and commercial properties served

3.5 million
customers

160
litres per person per day – average water use

4,500km²
supply area

16,500km
water mains

98
treatment works

192
service reservoirs and water towers

121
boreholes

1.39 million
household connections

Raising funds

The fundraising underpinning the investment programme is a core responsibility and focus for Kennedy. His first foray into capital markets after joining Affinity came in July 2014 via a reverse auction, which raised £50m. "We wanted to try something a bit different in terms of discovering the best price when issuing the bond. It takes it out of our hands and the banks' hands, and says to investors: you bid what you're willing to pay for on our credit and we'll see where we end up," he says.

Affinity also raised £40m a year later via a private placement with a single investor. The opportunity arose through investor

"We're not a huge issuer compared to some other corporates. We do quite small deals more frequently"

engagement, he says, which is an area he devotes much more attention to in this role than in previous ones.

How the private placement came about was that regulatory and accounting changes meant that some of Affinity's financial covenants didn't make sense any more and prompted a round of investor engagement. "We went to see a lot of our bondholders through a roadshow process and talked to them about the changes. We needed a vote to change all the documentation we had in place to put in new covenants," he explains.

Private placement in the UK is an area with a great deal of potential, he says. There are certainly opportunities with Affinity's existing bondholders – corporate investors such as M&G, Standard Life and Legal & General. "UK investors are looking for opportunities; they're looking to invest. It's easy for me to say with a UK-regulated utility with a good credit rating, but I think there are probably more opportunities for us."

The roadshow opened up discussions and questions on whether Affinity Water would issue more debt. "So we ended up privately placing the deal with a single investor. Following on from that [engagement] process, we tapped another existing bond, but placed it privately with a single investor on a delayed basis. Again it was quite different the way we structured it," he says.

The revisions to the covenants, the roadshow, the bond issue and the private placement all came together to treasury's benefit. As a result, treasury – Kennedy and treasury analyst Poonam Depala – was nominated for a company award for outstanding commercial acumen, which it won. "For the business to recognise that we're making a contribution to what the company is trying to deliver was very rewarding."

Affinity is likely, he says, to go back to the bond market one more time in this asset management period. "We've got enough cash to see us through for the next 18 months. We have loan facilities as well, but we try and pre-fund as much as we can and lock into rates, without trying to carry too much cash.

"We're not a huge issuer compared to some other corporates. We do quite small deals more frequently – so this £50m reverse auction or the deal we did placing £40m with one investor, for instance, rather than running a £250m benchmark deal," he says.

The water industry's regulatory framework is a core focus for investors, who are keen to talk about any developments on that front. The big talking point currently is inflation and the move to the consumer price index (CPI) from the retail price index (RPI). "Investors are incredibly aware of it because the way that the water sector regulation has been built has been around real cost. We have a lot of RPI debt outstanding as do a lot of our peers, so transition to CPI throws up a lot of interesting questions. It's another risk to manage. We have an RPI-linked bond out to 2045. [Our investors] are committed to us for quite a long time. They should quite rightly be interested."

But while the engagement with bondholders and the successful rounds of fundraising have been rewarding, the company award has been a genuine highlight for Kennedy.

"To win an award and be able to tell people what we're up to is really satisfying. Just to have the wider company know that we in finance are doing innovative things – that's been incredibly satisfying to have that feedback."

Liz Loxton is editor of *The Treasurer*

SHAUN'S TOP TIPS FOR SUCCESS

1

"Hard work."

2

"Read *The Treasurer* magazine and engage with the ACT where you can. The ACT runs so many events and ways for members to interact, there's no excuse."

3

"The AMCT qualification ensures I have the core skills to do my job properly. Without it I can say for certain that I'd not have had a chance of securing any of the roles that I have in the past few years. It is considered a minimum requirement for most senior treasury roles these days."

4

"My favourite gadget? The thought of not having my dishwasher wakes me up in a cold sweat. Inevitably, though, the miracle that is my mobile phone provides me with more joy, so it probably pips it to the tag of favourite."

5

"The most difficult question my CFO is likely to ask is: tell me what inflation will be next month/quarter/year – my forecast is always caveated and nearly always wrong."

6

"The best way to wind down after a stressful day is my walk to the station from the office – it gives me around 25 minutes of fresh air and a chance to work through any issues. Once I'm home, it's great to then spend time with the family; seeing my kids takes my mind off the stresses of the day and reminds me how important it is to make the most of life. And once they are asleep, a cold beer completes the job."

SHAUN'S CV

2013–present
Group treasurer, Affinity Water

2011–2013
Treasury manager, SmartestEnergy

2006–2011
Group treasury manager, Notting Hill Housing Trust

2005–2006
Treasury manager, assistant treasury manager, Circle Anglia

2003–2005
Treasury analyst, treasury officer, Circle 33

QUALIFICATIONS

Maths, operational research, statistics and economics BSc, **University of Warwick**; MSc Operational research and management science, **Lancaster University**; AMCT (2009)

BOARDROOM BASICS

No one wants to make a hash of briefing the company's directors. Sally Percy asks experienced treasurers how they get it right

A treasurer's place is in the boardroom. Not all of the time, of course, but some of the time at least. That is one of the principal findings of *The Contemporary Treasurer 2016*, the ACT's latest research into the evolving influence of treasury on corporate financial strategy and business growth.

Nearly 200 treasurers across the UK, continental Europe, Asia-Pacific, the Middle East and North America were interviewed for the study, which found that treasurers globally are contributing far more strategic advice to their organisations than they did five years ago.

It is not just business strategy that treasurers report on, however. Their board reports tend to encompass a broad range of subjects, from capital and liquidity management and risk management through to corporate finance, treasury operations and controls, and pensions management.

So just what does presenting treasury matters to the board entail? And is it really the horrifying prospect that it might seem?

Prepare to succeed

At energy giant Centrica, group treasurer Katherine Horrell reports to the 12-strong board on an annual basis. If she is presenting to the board in person rather than just providing a written report, Horrell makes sure that she's very familiar with her report and the treasury policies before she enters the boardroom. "If I'm presenting in person, I would normally go through it with the CFO beforehand and agree the headlines we want to bring out," she says. "But mostly I prepare by reading through what I've submitted and making sure I've got the latest information on topical issues. The board has asked about eurozone volatility in the past, for example."

Private equity- (PE) owned foam manufacturer the Vita Group has a board of four comprising the CEO, a bank-appointed representative and two directors nominated by the PE owners. Board meetings are held four times a year and group treasurer Chris King prepares written reports for each board meeting. From time to time, he may also be asked to present.

King's written reports are normally PowerPoint presentations on two or three topics – with no more than four slides per topic. He recommends preparing for the meeting itself by doing a run-through with peers. "That way, you can get wider challenge before you brief and also explore the 'what if' scenarios," he says.

Rando Bruns, head of group treasury at German pharmaceutical company Merck KGaA, has interactions with three different boards in his role – a management board, a supervisory board and a family board (Merck is 70% owned by family shareholders). Bruns mostly engages with the management board and the family board. The management board is currently focused on the company's credit rating in light of its $17bn acquisition of Sigma-Aldrich, the largest acquisition in the company's history. Meanwhile, the family board is regularly interested in financial risk management, particularly the company's management of pension risk and its use of derivatives to mitigate FX and interest-rate risk. "The management board is very close to the operational business so you don't have to explain as much to them as you do to the family board," says Bruns.

While treasurers don't normally present at board meetings in the Middle East, Gary Slawther attends all the board meetings for his company, Oman-based packaging company OCTAL. The board consists of five members, comprising the CEO, three directors who represent the investors and one non-executive director who has a chemical engineering background. Slawther has a treasury background, but because his job title is 'financial adviser to the CEO', he actually addresses a range of topics in his report. This could be from the previous quarter's results and the current cash and financing position through to marketing and new products.

The business culture of the Middle East has an impact on which aspects of treasury are discussed at the board meetings, Slawther says. "This is still the place where cheques reign supreme, so there is always a big focus on cash and liquidity. There is also a big focus on what is happening now in terms of the commercial operations – the immediate future is far more important than what will happen in five years' time." A tendency towards risk aversion and secrecy in business also means that boards are highly interested in protecting their markets and keeping competitors out.

> "If I'm presenting in person, I would normally go through it with the CFO beforehand and agree the headlines we want to bring out"

Question time

Horrell says that the questions posed by her board will vary according to the nature of the issues facing the company at the time. Centrica suffered a downgrade in 2015, which has made the company's credit rating a key priority for the board. "The credit rating has been one of the key issues for us over the past three or four years," she explains. "But in 2013, we did a debut bond issue in the US, so it tends to be whatever is topical in treasury."

Nevertheless, it is a case of 'expect the unexpected' when it comes to questions because they can be on any topic. "You can put out a paper that covers all the work you've done in the past year and you might expect questions in one area, but then get asked questions in another," Horrell says.

With King's board, questions tend to cover a lot of 'what if?' scenarios. "So if we're working on a pension issue, it might be: what is within the trustees' powers in terms of how they could react to our proposal?" He tries to answer the questions he can and then gets back to the board on any he can't answer at the time. "You cannot know everything and a good board is likely to have questions you can't always answer," he says. "But you should prepare sufficiently so that they are isolated questions rather than every question."

When it comes to answering questions, Slawther says it is important to be both diplomatic and respectful. "If I don't know the answer to a question, I'll take it away and do some research and then come back with an answer at the next board meeting."

IKON IMAGES

TOP TIPS FOR PRESENTING TO THE BOARD

Limit the messages that you want to make to as few messages as possible and keep them simple.

Use graphics and visuals to convey key points in a straightforward way. For example, a graphic of a 13-week cash-flow forecast showing that you're outperforming your budget or underperforming your budget gets the message across very clearly.

With written reports, remember to tailor your content towards the end audience.

Flag up potential risks early – for example, if projections show the organisation could breach financial covenants or liquidity is tighter than planned. Then say which actions treasury is taking to mitigate those risks.

Don't ask the board to consider very difficult or technical issues.

Avoid using the board meeting as an opportunity to announce surprises – either bad ones or apparently good ones. They won't go down well with any of the directors – particularly not the CFO.

IKON IMAGES

The CFO's view

David Tilston, former CFO of banknote substrate maker Innovia Group, has experience of sitting both sides of the table when it comes to treasury presentations. As a corporate treasurer earlier in his career, he reported to the board on matters including financial covenants, liquidity and refinancing. More recently, he has sat in board meetings while the treasury team has been presenting.

Tilston's advice for treasurers who are called before the board is not to talk about treasury in depth. "It's best to avoid having the board thinking about very difficult or technical issues," he says. "Warn them of any issues and then serve the answer on a plate so they are in a position to monitor the delivery of the solution. Getting into complicated discussions of treasury matters is not something to be done around the boardroom table."

Where treasurers slip up in front of the board, it is usually in two ways, Tilston explains. The first is by "making the presentations too technical and assuming a degree of treasury knowledge that may not be there for the majority of non-execs". Secondly, they don't manage to convey the key messages clearly enough.

As a board member, Tilston is focused on the following areas when assessing treasury's report: have we approved a policy around this area and are we complying with that policy currently? Is our trading on track from a cash and financial covenant perspective? And if I look at the forward projections – be they on cash, financial covenants, funding or currency – are we projected to be on track with our expectations or are things beginning to deteriorate? Then, if they are deteriorating, does the management team have a sensible plan in place that it is likely to deliver? At subsequent board meetings, I'll want an update on the deterioration and whether our mitigation plans are working.

Treasury does have a role in supporting the board's strategic decision-making, Tilston confirms. "If the board is looking to expand the company and that's going to require significant debt or equity funding, the treasurer has to immediately deal with strategic issues," he says. "If they know it can't be done, or the risks are unsustainable, then they are duty-bound to ensure the board understands this. Similarly, if it can be done, the treasurer is tasked with delivering the relevant debt packages in a way that supports the acquisition or the expansion. But it's pointless for the board to get excited about a debt-finance acquisition if it's not deliverable."

Bruns tries to translate common treasury terms into terms that board members find easy to understand. "The members of our management board are experts in pharma, chemicals, R&D or HR," he says. "So I do not assume they know all the treasury terms and I try to keep my presentation simple. I try to translate treasury-specific terms into terms they use more typically. For example, in treasury we might talk about ratios of cash flow to debt, but you can translate this into what it means in terms of EBITDA or profits or sales."

> "It would be nerve-wracking if there were questions I couldn't answer, so preparation is key"

Bruns adds that while boards tend to have a good understanding of the needs of equity investors, they can be less familiar with what debt investors require. So some background briefing from treasury is useful in this respect. "With debt investors, the contact is usually just with treasury or the CFO," he says. "Equity markets work differently from debt markets. An equity investor is interested in a growth story and wants a higher share price. A debt investor wants their money back. They have different interests."

Scary stuff?

So is presenting to the board really terrifying? "It can be a bit daunting to present to the board as they are very senior and you don't know them," acknowledges Horrell, whose board includes Rick Haythornthwaite, previously CEO of one-time FTSE 100 engineering company Invensys, and Carlos Pascual, formerly a senior adviser to the US Secretary of State on energy issues. "But I have always found the atmosphere in meetings to be supportive and helpful. They want to understand your area, rather than trip you up, so I have found it to be a positive experience."

Slawther admits that he relishes the challenge. "It's not nerve-wracking," he says. "It's more like an exam. If you're well prepared and feel confident about being able to answer questions, you should do well, but you should never get complacent. Also, a certain amount of adrenalin pumping helps you to concentrate and focus. It would be nerve-wracking if I felt I didn't know my stuff or there were questions I couldn't answer, so preparation, preparation and preparation is key – even if it's last-minute cramming."

If the thought of presenting to the board gives you minor palpitations, you can take comfort from the fact you probably won't need to do it for long. Most of the treasurers interviewed for this article normally address the board for between 10 and 20 minutes in total.

"When you present in person to the board, you have quite a limited window in which to do it," explains Horrell. "Also, often your slot never comes up quite at the time you're scheduled for – they're running ahead or they're running behind. You might have to speak within a shorter time frame, or just take questions. So you need to be flexible."

Seen and heard

Some boards have a greater understanding of treasury matters than others. So PE boards tend to have a good grip on cash, for example, and Horrell says that Centrica's board is "well versed" on treasury issues and financial risks.

Nevertheless, regardless of the overall level of treasury knowledge among the board, presenting to the board is still a great opportunity to raise the profile of treasury within the organisation and remind the organisation's most senior figures of all the great work that treasury does. Fortunately, leading treasuries have already got this worked out.

"Our board sees treasury as the custodian of financial risk management," says King. "So when there is market volatility, they are very keen for us to be present."

Sally Percy is a business and finance journalist, and former editor of *The Treasurer*

May the best bank win

THE RFP CAN BE A BEWILDERING AND EVEN INTIMIDATING EXERCISE. ANDREW BURGESS SUGGESTS SOME WAYS FORWARD

You've been overheard saying "there's got to be a better way" about the banking. Now somebody wants you to find that better way – and to prove its worth before the firm puts its money where your mouth is.

The request for proposal (RFP) is the classic way to gather information about the complex range of services a bank provides. Done right, it lets the banks know what you are looking for. It conveys that you are serious about changing or adding services, and want the best fit for your needs as well as requiring those needs to be assessed fairly and professionally. The desired outcome: a smooth transition to improved business function and profitability. Done wrong, it's a time-consuming waste of resources that confuses everybody and results in the business overpaying for functions it doesn't really need, ones that might even impede normal functionality.

The usual procedure is you generate a report (the RFP) detailing what you are looking for from your future bank and asking how they would meet the requirements you set out. This is sent round several candidate banks. The banks respond with written suggestions. You select a shortlist to meet and enter into more detailed discussions with. From those discussions, a final decision is made. Ideally, this should not be the point where you realise that the wrong questions were asked at the start and that the whole exercise needs to be repeated.

The two key stages are: drafting the RFP and the discussions with the banks. An analogy would be a promising new graduate drafting a CV and having multiple job interviews. You get to choose which employer, but it better be a good choice, because once you are committed to investing your future with one firm, it is expensive in time, money and lost opportunity to change track if they don't behave as expected, or if they do, but you discover that this is not what you really wanted.

Drafting the RFP

To do this well you need to know where you are, where you want to get to and ideally how you would like to travel. So you need to think about the following issues:

- Your scope: are you looking for a new main relationship bank; a zero-balancing pool provider; a quick access to the Single Euro Payments Area system; or a well-placed bank in your new target growth market?
- Your current actual situation as it *is*; not as it should be. It is best if this is backed up by descriptive statistical data of the volume and type of transactions you actually have to process, both regularly and on those special circumstances that in practice turn up so often.
- Your intended end result, ideally both the perfect and acceptable cases.
- Your priorities for making the decision; in *ranked* order (none of this 'they're both equally important' rubbish). If everything else was equal, which factor would swing the decision?
- Your deal breakers: what the bank must be able to deliver should be front and centre. There is little point being at the point of signing having failed to ask: "by the way, are you able to implement this by the end of next month?", for instance.
- Your decision-makers: if corporate finance head office will be making the final call based on global funding provision alone, then there is little point asking regional treasury hubs to do a detailed RFP to assess transaction costs.
- Your biases: does anyone involved in the process have noticeable feelings for or against any of the banks involved? Identify if ABC bank missold your first mortgage or XYZ bank employs your nephew, and then neutralise any non-relevant impact on the decision.

Not all this data needs to go in the RFP itself, and some definitely shouldn't, but you need to clarify what matters for your decision-making. Then you can produce the questions to give you all the answers needed.

Letting the first draft RFP sit untouched for a few days before coming back and checking it with fresh eyes is almost always useful – as is a proofreader. Once it's good to go, send it out and wait for the replies.

The interview process

Once the written answers have been sorted down to a shortlist, it's time to get face to face with the banks. You might want to consider having a wild-card bank that barely makes the shortlist as a first-practice interview for what to expect.

Who to take to the interview? The short answer to this is: anyone whose opinion you'd respect and want to take into consideration. Specialists from cash management and IT support are pretty much a given. Everyone takes notes and everyone picks up on different things. You shouldn't worry, either, about asking more questions for clarification later – it's not as if the bank will refuse. Do discuss each interview afterwards, however,

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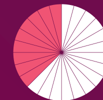
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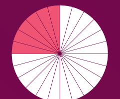
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both to check everyone understood it the same way and to identify areas to check in the next interview.

What you want to find out is:

- What they offer and how it meets your needs.
- What they can actually deliver, ideally with minimal discrepancies to the above.
- When it will be in place, and how the bank deals with implementation problems.
- What it will cost, and that this quote is guaranteed.
- How it will operate once in place.
- Who your contacts are and their availability.
- Any systems limitations or changes needed; and a strong sense of how robust the solution is likely to be.
- Any legal restrictions on yourselves or the bank.
- Expected functional life – if next year's regulatory change means it won't be functional, why install it?

You should also ask to be put in touch with some reference customers willing to discuss the implementation process. Ideally, these should be the three most recent customers, not just the three happiest.

Once the interviews and any follow-ups are carried out, it's decision time. You can take soundings, and take those into account, but can't delegate this decision. Writing out your decision with reasons why you propose accepting one bank and rejecting the others and reading it back out loud a few days later is a good way to back check yourself.

While you might feel under time pressure in terms of making a decision, you should bear in mind that making the right decision should, properly speaking, outweigh that. Don't feel hurried. You're allowed to ask more questions and talk to more banks right up until the point where you are fully happy with the choice.

And if it comes down to two banks that are finely balanced... toss a coin. Not to see the result, but because you'll know which one you're hoping for while the coin's still in the air.

WHY AND WHY NOT TO INVOLVE CONSULTANTS

Consultants can be useful in the RFP process, especially if you don't mind being seen to subcontract your thinking, but they can't make the decision for you. What they can offer is:

- Data collection about what you do. Often this is simply going and talking to the operational-level staff, then presenting it as high-end insight. Talk to your own people first and don't pay for what you've already got.
- Outsider perspective: having to answer "why do you really want that?" before the RFP is drafted can avoid habitual thinking becoming a key criterion.
- Data collation: if your team is too stretched to go back through 10 years of bank statements to check the level, this can be farmed out.
- Editing the draft RFP and checking it includes all the relevant data not just that matching the function of interest: there's little point having a great cash-pooling system, if your new bank won't deal with exotic, but commercially important currencies.
- Added experience and authority: provided they have done several end-to-end RFPs before. This can both anticipate implementation problems and defuse sales techniques.

The key with consultants is to make it clear from the outset they'll be assessed by how effectively the implementation of the RFP decision goes (as will you). If future support is needed to deal with the problems, you'll be getting it from your new consultants.

Tactical moves from banks

Once you've invited banks into the process, watch out for the following:

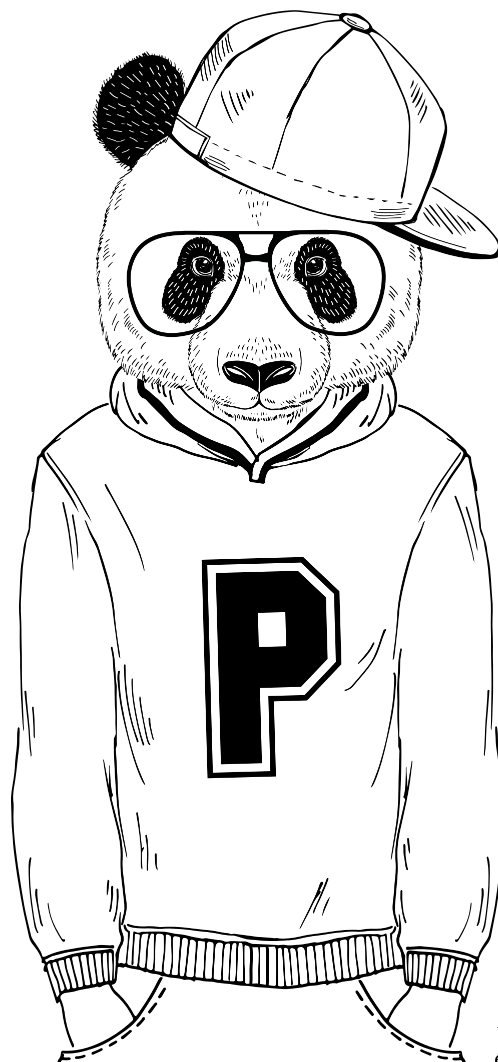
- **Courtesy calls** to find more information than is included in the initial RFP document for clarification. If it's something genuinely missed out of the document, don't forget to highlight it to the other banks. Your aim is to have a level information playing field (but do note which bank did the more diligent research and found the omission early).
- **As in any sales situation,** rubbishing a rival bank's services, rather than talking up their own, usually tells you who the bankers in front of you are most worried about.
- **The treaty room.** Off-site visits to the bank's plush private banking suites, rather than your drab Formica and grey carpet-tiled office might make some of your team feel overawed and off balance – it's intended to and will if you don't recognise it.
- **Style points.** The bankers you talk to will be acting as a sales team, whether they are your future relationship partners or not, they are there to impress and land a sale. Sharp suits and business cards are to be expected. Make sure all your team knows that, and that there's no need to compete or worry.
- **Practice.** At least some of the bankers will have been involved in multiple RFPs; most treasurers a couple at most. You can accept some guidance, but not railroading.
- **"Don't worry** about that" is the reddest of red flags.
- **Listen with your eyes:** if their IT support guy isn't making eye contact while their team leader is discussing system reliability, you might want to probe. If the senior banker interrupts and corrects their proposed relationship banker constantly, you've got a problem.
- **Ask the questions** you'll regret not having asked later. "What have you learnt from previous implementations like this?" is a good one.

The RFP is the classic way to gather information about the range of services a bank provides. Done right, it lets the banks know what you are looking for

Andrew Burgess is FX manager at GE Alstom

PANDA'S GROWING PAINS

PANDA BONDS ARE KEY INSTRUMENTS IN THE EFFORT TO TRANSFORM CHINA'S LOAN MARKET INTO A TRULY INTERNATIONAL BOND MARKET, BUT DEVELOPMENT HAS SLOWED. WARUT PROMBOON LOOKS AT WHAT IS NEEDED FOR THE PANDA TO KEEP GROWING


SHUTTERSTOCK

If the Panda bond market is to return to growth, it will need encouragement. Here we look at five areas where regulators, providers and other market players could help make this product more attractive and familiar to the international investment community.

1. More clarity on Panda bond regulations

We desperately need improvement in Chinese regulations and transparency of the Panda bond issuance procedure. Unlike UK, Hong Kong or US laws, governing most international bonds, Chinese regulations (ie bankruptcy law) remain untested and/or unknown to foreign issuers and investors. Investors will need to be able to price the bonds, based not only on the ability to service debt, but also on the willingness to do so. The latter requires knowledge of the Chinese law and regulations governing Panda bonds.

Chinese regulators are moving up a steep learning curve on Panda bonds, but many investors have seen the People's Bank of China (PBOC) as reactive, rather than proactive, when it comes to regulating new products. No matter whether the sentiment is right or wrong, Chinese regulators need to move fast to clarify the official rules in order for the Panda bond market to grow at all. While we believe that PBOC will take its time announcing the new rules, we expect the rules to favour Panda bond development. We just hope the ruling will not come too late now that US dollar bond issuances are picking up.

2. Continued rate cuts

The PBOC cut rates to stimulate China's slowing economy. In our view, investors' expectation of further rate cuts generates mark-to-market (MTM) gain expectation for Panda bond investors with renminbi as a natural currency. In addition, the declining yield environment in China will lower the funding cost and refinancing risk for Panda bond issuers.

On the other hand, stronger-than-expected economic growth in China may stop the rate cuts and stunt the growth of the Panda bond market. Also, a more gradual-than-expected rate hike in the US or a more aggressive-than-expected rate cut in Europe could cause competition for offshore liquidity that would, otherwise, be aimed at Panda bonds.

It is important to note that the PBOC's rate cuts alone may not necessarily make it cheaper to issue Panda bonds. First, issuers have to find it attractive to issue Panda bonds (versus bonds denominated in other currencies). Second, investors may have a better alternative to Panda bonds in which to invest. The former will depend on the speed of a rate hike in the US versus that of rate cuts in the eurozone and China. The latter will depend on whether investors can still expect attractive MTM gains on Panda bonds or whether they think US dollar or euro bonds will offer them better returns. For example, should the US Federal Reserve (the Fed) raise rates more gradually than expected, US dollar bonds will perform unexpectedly well relative to Panda bonds, and foreign investors could decrease their bond portfolio weight dedicated to Panda bonds. Likewise, should the European Central Bank lower rates more aggressively than expected, European issuers may find it cheaper to issue euro bonds rather than Panda bonds.

3. Liquidity

The PBOC's rate cuts will boost liquidity for Panda bonds, but onshore liquidity could also stem from a capital-control mechanism and/or a return of investors' confidence in the renminbi's value against the US dollar. China's slowing economic growth and declining investor confidence in renminbi's value against

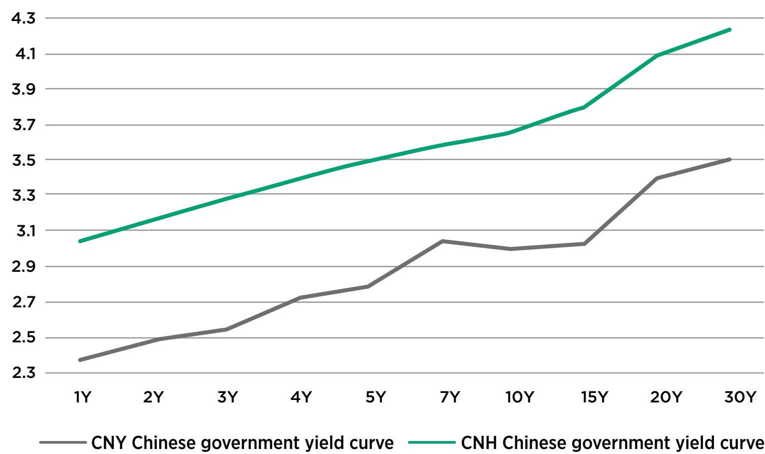
the US dollar have hampered offshore renminbi liquidity.

Overall, we expect the majority of Panda bond demand to come from existing onshore liquidity, not offshore liquidity. First, there is onshore liquidity that cannot be easily deployed outside China. Second, Panda bonds will offer onshore investors no currency risk and more capital gain opportunities on the easing cycle in China.

PBOC has raised onshore liquidity through different tools, such as reserve requirement ratio (RRR) cuts, rate cuts and the PBOC's reverse repurchase agreement activities. China's M2 money supply rose 12.8% year-over-year in April (below a median estimate of a Bloomberg economist survey of 13.5%). The central bank lowered its RRR for major Chinese banks four times in 2015 to the current 17.5% (China's RRR was 20% from May 2012 to February 2015). Falling inflation in China enabled PBOC to cut rates to boost the Chinese economy. A 40-base point one-year benchmark lending rate cut in November 2014 was the first of its kind since July 2012. The central bank cut one-year benchmark lending and deposit rates five times in 2015 to the current 4.35% and 1.5%, respectively. The spread between the mentioned lending and deposit rates has been 285 base points since November 2014 (down from 300 base points). We would not be surprised to see this spread tightening even further.

Despite recent improvements in Chinese economic data, we expect the PBOC to continue cutting RRR and interest rates to boost spending and investments onshore. The rate and RRR cuts will increase money supply and, therefore, demand for Panda bonds as well as interbank assets, all of which will further lower onshore yields, in our view.

ONSHORE (CNY) VERSUS OFFSHORE (CNH) RENMINBI YIELDS OF CHINESE GOVERNMENT BONDS



SOURCE: BLOOMBERG

4. Attractiveness to investors

In addition to returns, we believe the following characteristics will increase demand for Panda bonds. First, Panda bonds, issued by familiar international issuers, will save investors extra credit work. In our view, this familiarity with issuers will lead to Panda bonds becoming even more liquid than CNY bonds (issued by onshore Chinese issuers). Better knowledge of issuers will allow investors to better differentiate credit quality, translating into spread differentials between strong versus weak credits, in our opinion. The development of the renminbi bond market depends on knowledgeable and well-informed investors who can price bonds efficiently. Panda bonds could eventually attract more international investors, which will make available more research and opinions.

Second, we believe Panda bond development will introduce more international issuers to China. These issuers will bring with them a more transparent practice, which, we believe, will motivate Chinese issuers to follow suit. More savvy investors will encourage Chinese issuers to meet international disclosure standards. In our view, improving disclosures in China is crucial for the country's transition to a more international financial hub. In other words, a lack of transparency will also stall the development of Panda bonds.

> Chinese regulators need to move fast to clarify the official rules in order for the Panda bond market to grow

5. Credit-quality differentiation

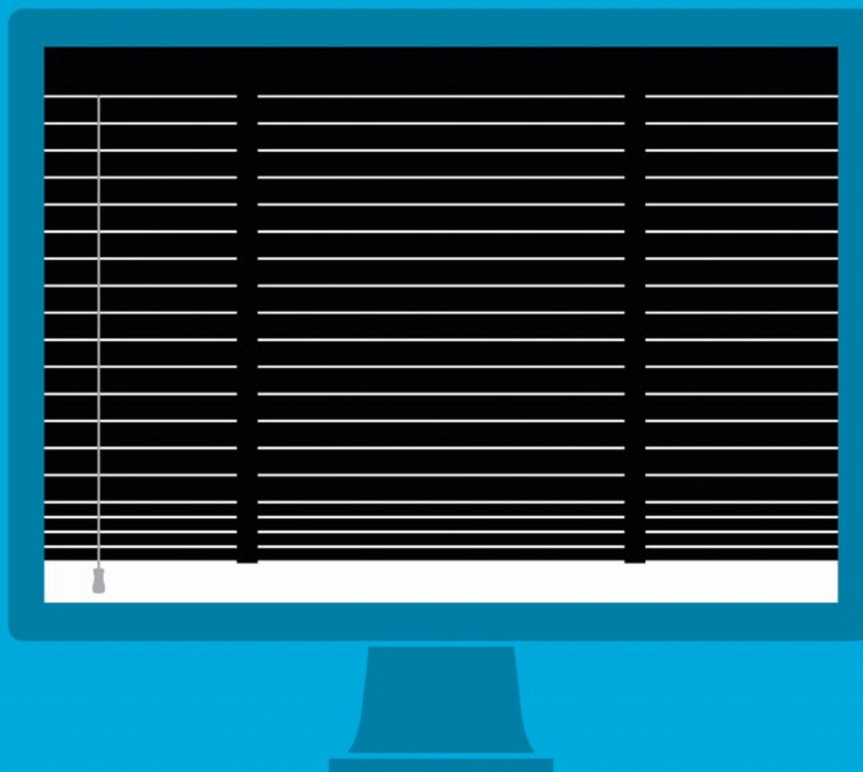
Investors will need to be able to differentiate credit quality among Panda bonds whether it is through credit ratings, in-house credit teams, asset managers and/or sell-side research houses.

The PBOC requires that all Panda bonds be rated by Chinese credit rating agencies (although the central bank has approved some exemptions). For Panda bonds, issued by unknown issuers, a proper credit rating is crucial for an efficient allocation of capital. The market opinion is that Chinese credit ratings do not provide sufficient credit-quality differentiation.

A domestic rating of AAA accounts for an issuer's systemic importance to the Chinese economy, which leads to government support, in our judgement. The domestic ratings are also derived from rankings among Chinese peers, not international peers. The abundance of domestic AAA ratings has made it difficult for investors to price Panda bonds without doing their own credit homework. Arguably, many Panda bonds rated AAA by Chinese credit rating agencies will have very different international ratings. That said, we believe a Panda bond rating should be accompanied by an international issuer rating.

A lack of a proper international rating scale attached to the Panda bond rating could lead to investors' inability to assess credit risk properly and that could lead to credit losses and/or insufficient capital cushions. In other words, issuers may not necessarily get to borrow at a funding cost that reflects their credit risk. We admit that it is a challenge for Chinese credit rating agencies to adjust their rating scales, but bond investors need the ability to convert a Panda bond rating into an international scale in order to compare among international peers.

Warut Promboon is chief rating officer at Dagong Global Credit Rating Ltd in Hong Kong



(No) private places

THE ABILITY TO COLLECT, STORE AND SHARE INFORMATION ON INDIVIDUALS HAS NEVER BEEN MORE IMPORTANT TO BUSINESSES, BUT A PATCHWORK OF PRIVACY RULES MAKES FOR A SIGNIFICANT COMPLIANCE BURDEN. DETLEV GABEL AND TIM HICKMAN LOOK AT THE CHALLENGES AHEAD

Legal systems around the world take different approaches to the question of how best to balance the right to privacy with the needs of a modern economy. On the one hand, individuals generally want (and vote for) strong protection of their own privacy. On the other hand, allowing businesses to lawfully use certain information about individuals is increasingly important to global commerce. Striking a fair balance between these competing interests is not an intuitive or straightforward process.

Many countries have no strong laws in this area at all. Of those countries that do have such laws, some (notably the US and Canada) take a 'sectoral' approach, imposing privacy compliance obligations on businesses, based on the nature of their activities. Other countries (notably in the EU, and increasingly in Asia and Latin America) adopt an 'omnibus' approach, imposing essentially the same privacy compliance obligations on all businesses, regardless of their size or the sector in which they operate.

This has meant that international businesses frequently face inconsistent privacy compliance obligations from one country to the next. Even among the EU countries (whose existing privacy laws all stem from a common source – Directive 95/46/EC) national privacy compliance obligations vary significantly. Data-transfer restrictions are much tighter in Germany than in the UK. Data processors need to register with the local Data Protection Authority in Ireland, but not in Spain. Levels of fines for the same infringement may soon be an order of magnitude higher in France than in any other EU country. The relevant privacy laws in the UK only apply to information about living persons, but equivalent laws elsewhere in the EU can extend to deceased persons as well. And so on.

IKON IMAGES

A new sewing kit

The EU institutions, to their credit, have recognised that this patchwork of similar, but not identical, compliance requirements across the EU is unhelpful to anyone who is trying to do business across Europe. In response to this, and a number of other problems, legislators in the EU published a new law, entitled Regulation 2016/679 (the General Data Protection Regulation or GDPR), on 4 May 2016.

It is difficult to overstate the significance of the GDPR from a business perspective.

It is extraordinarily wide-ranging – the rules set out in the GDPR will directly impact every business based in the EU, as well as every business that operates in the EU, even those based abroad. The GDPR is extremely serious – it dramatically increases the maximum fines to the greater of €20m, or 4% of annual worldwide turnover. These figures are deliberately intended to attract board-level attention.

Although the UK is set to leave the EU, it is unlikely that the negotiations of the UK's departure will be completed before enforcement of the GDPR begins on 25 May 2018. Whether the GDPR will continue to apply in the UK after the conclusion of the negotiations remains unclear at this stage.

Perhaps the most ambitious change that the GDPR seeks to achieve is the harmonisation of the data-protection laws of all countries in the EU.

This is no small challenge. First, each country in the EU has its own legal tradition regarding the right to privacy, and national courts with their own case law and precedents on privacy-related issues. Second, each EU country has its own Data Protection Authority, which has its own views on the ways that businesses should be regulated in relation to the use of information about individuals. Third, the EU institutions do not have the power to pass laws in all areas that affect privacy. For example, the EU cannot pass laws regarding employment, national security or freedom of speech – all of which directly intersect with the right to privacy.

Towards a less patchy patchwork

To address these challenges, the GDPR introduces several tools designed to increase the degree of harmonisation within the EU. Most significantly, the legal form that the GDPR takes is known as a 'regulation'. This means that, from the date on which enforcement begins, the GDPR will take effect in each EU country, without the need for national interpretation. The same black-letter law will apply in all 28 EU countries. In theory, this will drastically reduce the number of inconsistent privacy compliance obligations that businesses face across the EU.

But there remains a significant risk that different national Data Protection Authorities might take their own slant on the GDPR, interpreting the black-letter law in light of their own views of how businesses should be regulated, and how the right to privacy should be protected. To address this risk, the GDPR creates a legal mechanism (known as the 'consistency mechanism'), which is designed to ensure that Data Protection Authorities all interpret the law in a consistent manner.

However, it must be acknowledged that the GDPR will not achieve complete harmonisation of privacy laws across the EU. Businesses will continue to face inconsistencies in their privacy obligations from one EU country to the next, because national variations will inevitably persist in some areas. But, there is genuine optimism that the GDPR will mean that businesses face a significantly more consistent set of privacy compliance obligations across the EU.

> Although the UK is set to leave the EU, it is unlikely that the negotiations of the UK's departure will be completed before enforcement of the GDPR begins

What should businesses do now?

Having a consistent set of privacy compliance obligations across the EU is really only helpful if businesses understand what those obligations are. Under the GDPR, the obligations are many, and they can be quite technical in nature. Selected examples of particularly important obligations include:

- **Record keeping** – All businesses that are subject to the GDPR will be required to keep detailed records of the ways in which they (and their subcontractors) use information about individuals. This is not a simple task. It requires a thorough understanding of a business's day-to-day operations, and regular reviews to ensure that new business developments and processes are reflected in the records.
- **Appointing a data-protection officer** – Businesses that regularly and systematically monitor individuals, or process sensitive information about individuals on a large scale, must appoint a data-protection officer, who is responsible for data-protection compliance by the relevant business in the EU. A single data-protection officer can be appointed for an entire corporate group, but it is essential to ensure that that person has sufficient powers and resources to fulfil his or her duties.
- **Seventy-two-hour data breach reporting** – The GDPR requires businesses to report data breaches to the relevant Data Protection Authority within 72 hours of detection – an extremely short period of time. The key to meeting this deadline is a decisive allocation of responsibilities, and clear lines of communication. In practice, the person most likely to discover the breach (usually an IT technician), the person to whom it should be reported (usually a member of the legal team), and the person who will make strategic decisions (usually a manager or board member) rarely interact in their ordinary duties. Consequently, it is essential for businesses to ensure that these individuals are used to working together and that they each understand their respective roles and responsibilities, in order to meet this 72-hour deadline.

These examples are illustrative of the significant changes that businesses may need to make, both organisationally and operationally, in order to comply with the GDPR. As enforcement of the GDPR will not begin until 25 May 2018, businesses have a limited window in which to prepare for its impact. It is vital for businesses to ensure that they have set aside enough time, and a sufficient budget, to achieve the necessary changes within this deadline.

Dr Detlev Gabel (left) is a partner in White & Case's Frankfurt office. He specialises in data-protection and technology law

Tim Hickman (right) is a partner in the firm's UK office and advises on all aspects of UK and EU privacy and data-protection law

CLOSE ENCOUNTERS

DISCLOSING CONFLICTS OF INTEREST CAN BE MADE EASIER FOR EMPLOYEES, SAYS KEITH READ, BUT ORGANISATIONS SHOULD BE SENSITIVE ABOUT THE LEVEL OF SEVERITY

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Examples of conflicts of interest in business are far from hard to find. In one example, an investigation highlighted that a COO had engaged his wife to undertake a human resources review and subsequently made payments to a company owned by his wife, of which he was the company secretary. Payments over two years totalled nearly £100,000. There was no conflicts of interest system, no clear procurement controls and totally inadequate separation of duties. The payments were also not disclosed as a related-party transaction.

The issue of employing relatives comes up repeatedly when looking for potential conflicts. Take, for example, the case of the senior manager who employed his wife and also his daughter, son and the former finance officer's son. The senior manager's daughter was engaged as a consultant for 11 months at a cost of nearly £56,000, yet this figure was not declared in the accounts as a related-party transaction. Investigators were subsequently told that it was apparently *not clear* from the guidance what constituted a 'close relative' – the trigger for a declaration. The senior manager's son was employed for five months and paid around £19,000, and his wife was paid £6,000 for consultancy. The senior manager resigned and became the subject of a police investigation.

In a third example, a contract for facilities management services was awarded to a supplier without any justification. It subsequently came to light that the manager knew the supplier who was awarded the contract well. Both were involved in another company together. Clearly, the manager should have had no involvement in awarding the contract, but made no declarations of a conflict.

What are conflicts of interest? While there are several formal definitions, such conflict occurs when circumstances create the risk that an individual's judgements or actions are impaired or influenced as a result of other interests, or considerations. Invariably, such conflicts involve the exploitation of a role or position for personal, familial, related-party or similar gain – a gain that can be financial, favour or other form of benefit.

Clearly, a conflict of interest can range widely in severity, and can be actual or perceived, but just the perception alone can be damaging, as it goes to the very heart of an organisation's corporate governance.

The corporate shield

As the examples above show, conflicts of interest can represent a very significant issue for organisations, embracing the kind of activity that any organisation should be trying to avoid, ranging from fraud, bribery, crime and price fixing right through to ethics, bias, nepotism, discrimination, reputational damage and questions of integrity. Moreover, major organisations and public bodies can also face a legal challenge over decisions, including contract awards. Often, such conflicts can have long-term and wide-ranging consequences, particularly where the conflict has resulted in the choice of a poorly performing or relatively costly supplier.

However, despite these issues, organisations – that may have an otherwise generally effective compliance programme – often find conflicts of interest simply too challenging an area. This can have the direct result that their conflicts of interest activities are virtually non-existent, notional, ineffective or inconsistently applied.

In recent years, most organisations have invested

heavily in their anti-bribery and corruption programmes. However, it could be argued that such investment is largely in direct response to legislative developments, such as the UK Bribery Act, Foreign Corrupt Practices Act and similar statutes, which, although differing in detail, have very similar core requirements.

Arguably, the situation is different when it comes to conflicts of interest. Some countries, such as the US, adopt a generally rules-based approach to conflicts of interest, some, such as the UK, take a broadly principles-based approach and others take no specific approach, or an approach that is a by-product of other legislation.

Whatever the approach, the *direct* legislative drive for a conflicts of interest programme is variable, with the consequence that organisations often expose themselves to completely unnecessary risk, by failing to realise the benefits of an effective conflicts of interest programme. Without question, this is a crucial element of an overall compliance programme and, when properly joined up with other compliance activities, represents an effective compliance corporate shield.

As the examples above have already shown, there is invariably a link between conflicts of interest and corruption, in all its types. However good an organisation's anti-bribery and corruption programme, without a comparably effective conflicts of interest programme, the organisation will, without doubt, be exposed. That exposure can be both direct and indirect, with bribery being one typical consequence of the conflict.

Challenge and opportunity

Many organisations recognise that conflicts of interest are a key element of their overall compliance and ethics programme, but discover that the practicalities of managing conflict of interest day to day can be challenging.

There is an argument that conflicts of interest disclosure programmes can go too far and have unforeseen consequences. One example I have come across occurred within an organisation of 150,000 people. What came to light in this example was a single mother with three children working part-time in a local burger bar for additional cash, who became hugely distressed – understandably – at the prospect of disclosure leading to the loss of her second (but very low-risk) occupation – one on which she depended.

Clearly, this was not the intended result of the disclosure programme and it is an incident that ultimately resulted in a rethink and a risk-assessment approach that takes into account the severity of a conflict of interest (see matrix above).

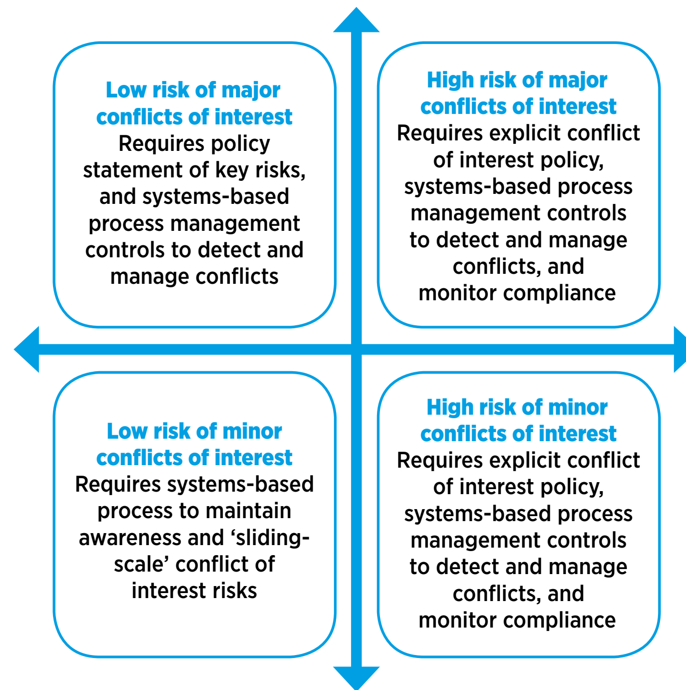
This type of approach enables a clear focus to be initially established on the highest conflict of interest risks – typically, in senior management, procurement and in-country managers – before extending the process further. However, simple analysis of likely annual turnover in employees, roles, responsibilities, reporting arrangements and personal or professional relationships indicates that keeping the conflicts of interest system up to date is inevitably very challenging, particularly when the full 'request-reminder-escalation-feedback-decision' cycle involved in managing conflicts of interest is taken into account.

It is here that, increasingly, conflicts of interest management systems are coming into their own. Crucially, these systems are straightforward and non-threatening, which makes it easy for employees to be thorough and forthcoming in their relationship disclosures. As key employees' roles, reporting lines and relationships change, disclosures can be requested automatically, quickly updated and automatically flagged should clearance need to change. This significantly reduces the administrative burden of redundant disclosures and minimises the time and effort required of employees. This in turn leads to more high-quality disclosures containing fuller *genuine* information, in a relatively simple and easy-to-understand format.

This data can then, crucially, be linked with an organisation's compliance reporting, whistle-blower hotline and training systems, and core HR data to create an effective reporting tool with visibility of the wider picture on conflicts, and potential misconduct. Linked to effective compliance communications, managing conflicts of interest then moves from 'chore' to essential tool in the corporate governance armoury – such that employees are alert to the potential for a perceived or actual conflict.

But how far would you go? It is generally relatively straightforward within local laws to identify companies and directorships registered to individuals, and then compare that to their conflicts of interest disclosure, if they have made one. Had a conflicts of interest management system been in place, that would likely have gone some way in exposing the COO in the first example above – well before the contract was placed and the £100,000 paid.

DEGREES OF RISK AND CONFLICT



> There is invariably a link between conflicts of interest and corruption

Keith Read is an independent compliance consultant

Under the weight of numbers

AMRIT JUDGE AND VIKRAM FINAVKER ARGUE THAT, FAR FROM BEING SPECULATIVE, CORPORATE HEDGING SHOULD BE ENCOURAGED AND EXEMPT FROM THE PROPOSED TRANSACTION TAX

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The question of whether firms are using derivatives for hedging or speculation is important in context of attempts by regulators to curb the use of OTC derivatives as a response to the 2008 financial crisis. It is also significant in terms of concerns about systemic risk in the financial sector and, more recently, the prospect of the introduction of the financial transactions tax (FTT).

The FTT has generated widespread concern among financial institutions and the corporate sector. Derivatives markets are predicted to bear a high burden of the FTT. According to a PwC literature review on the FTT[1], the increase in direct costs on derivative transactions as a result could be in the region of 18 times the bid/offer spread in normal market conditions.

The PwC review points to the European Commission's impact assessment of the FTT, which estimated that the tax would reduce volume in the derivatives market by between 70% and 90%, resulting in a significant hike in costs. This is anticipated to have an impact on the risk management capabilities of the corporate sector, as well as that of financial institutions. For example, the PwC report predicts an annual cost of €1-3bn to EU corporates for FX and interest rate (IR) risk management, and suggests that the taxation of intragroup derivative transactions for hedging could generate a significant negative impact on the economics of corporate risk management.

In attempting to discourage socially undesirable transactions, such as excessive risk taking, the FTT may inadvertently also adversely affect more desirable activities, such as hedging. We believe that the FTT in relation to corporate derivative transactions will be necessary only if it can be shown that the corporate use of derivative instruments gives rise to systemic risk. We argue that it will only do so if non-financial firms are using derivatives for speculation.

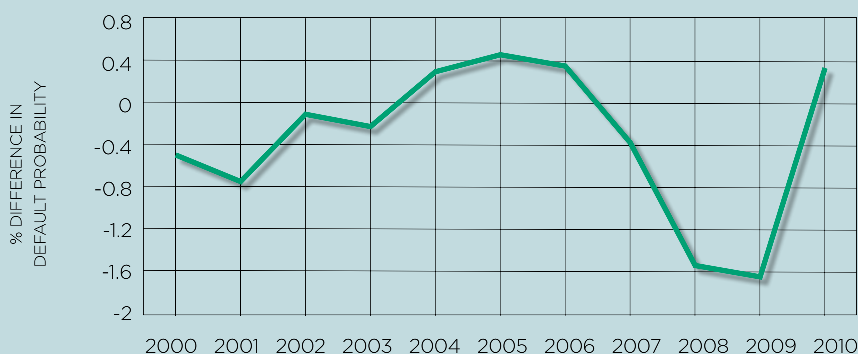
This question is important in a UK setting, compared with, say, the US. As previously pointed out (*The Treasurer*, May 2016, page 48), the bankruptcy code in the UK is considered to be creditor friendly, which makes the likelihood of a UK firm falling into administration and, ultimately, liquidation, much greater than that faced by US firms. This would imply that UK firms have a greater incentive to mitigate the effects of financial distress and that should manifest itself in the form of a strong negative (inverse) relationship between derivatives use and measures of the likelihood of firm financial distress.

Derivative users

Data on UK firms' use of financial derivative instruments is hand-collected from annual reports of all the non-financial firms in the top 500 of London Stock Exchange listed firms. A firm is classified as a derivative user if it discloses in its annual report that it uses foreign currency (FC), IR or commodity price (CP) derivatives. Over our sample period, 74% of firms disclosed that they used FC derivatives, 71% indicated that they used IR derivatives and 10% were using CP derivatives. A forward contract was the most popular FC derivative, employed by 62% of firms, followed by FC swaps, which were used by 32% of firms, and then FC options, used by 10% of firms. Among firms using IR derivatives, IR swaps were the most popular, used by 58% of firms, followed by forward-rate agreements employed by 33% of firms and, finally, IR caps or collars were utilised by 11% of firms.

Firms in our sample have relatively high levels of foreign

PERCENTAGE DIFFERENCE IN DEFAULT PROBABILITIES BETWEEN DERIVATIVE USERS AND NON-USERS 1999–2010



sales, with the mean and median values of foreign sales close to 60%. In comparison, US firms in the S&P 500 have, on average, around 20% of foreign sales with a median value of only about 12.5%, which suggests that UK firms possess on average much higher levels of FC exposure than their US counterparts. These exposure characteristics support our assertion that the UK is a good setting for examining the effects of derivatives on firm default probabilities.

> This finding suggests that derivative users are more resilient or perhaps hedge more intensively during periods of economic and financial downturn

We begin our analysis by examining the time-series variation in the probability of default for all-derivative users and non-users for the period 1999 to 2010.

The graph above shows that the difference in default probabilities between derivative users and non-users reached its maximum at the end of 2008, at the height of the financial crisis. The previous maximum difference between derivative users and non-users was during the economic slowdown of 2002, which seems to suggest that periods of heightened economic and financial uncertainty have a greater impact on firms that do not use derivatives relative to firms that do.

One statistical drawback of this analysis is that it fails to control for other firm-level differences between users and non-users, a factor that could be driving these results. To overcome this shortcoming, we run a multivariate regression model, which controls for several firm-specific factors that might also have an impact on firm-default probabilities, such as leverage, profitability, liquidity, firm size, equity return volatility and a firm's stock market return. We also interact our derivatives use variable with year dummies, which allows the coefficient on the derivatives use dummy in our regression equation to vary by year. In essence, we estimate the effect of derivatives on the probability of default separately for each year of our sample period in order to investigate whether the impact of derivatives use varies over time.

Default probabilities

In the graph we plot the estimated yearly derivative coefficients obtained from running the aforementioned regression model. A negative (positive) value indicates that derivative users had lower (higher) default probabilities than non-users after controlling for the impact of other factors. The graph shows significant variation over time in the effect of derivatives on the probability of default. It is noticeable that the effect of derivatives is highly negative in the years 2000-2001 and the period 2007-2009, and positive during the years 2004-2006.

This variation in the impact of derivatives on the probability of default seems to be consistent with the macroeconomic and financial risk environment prevailing during these periods. In other words, our results show that the negative impact of derivatives use on the probability of default is greater during unfavourable macroeconomic and financial or credit risk conditions, leading to a larger negative value for our derivatives coefficient at this time. This finding suggests that derivative users are more resilient or perhaps hedge more intensively during periods of economic and financial downturn.

Conversely, during relatively benign credit risk conditions, such as those witnessed between, say, 2004-2006, our results indicate that derivative users had slightly higher default probabilities than non-user firms. This finding is consistent with the notion that derivative users were perhaps hedging less of their exposures during these years by way of a selective hedging strategy.

For the overwhelming majority of firms in our sample, disclosures in annual reports suggest that firms are using financial derivatives for hedging, that is, risk reduction. Our empirical results are consistent with this as they show derivative use lowers firms' default probabilities. This, in turn, should lower the credit risk faced by lenders and consequently lower the credit risk premiums charged to borrowers, which implies a clear economic benefit arising from the use of derivatives by corporates. Furthermore, our findings indicate an interesting time variation in the effect of derivatives on the probability of default in that the impact seems to be greater during periods of macroeconomic and financial markets uncertainty.

In conclusion, we believe that our evidence provides support for the argument that corporate derivative transactions should be exempt from the FTT and that public policymakers should be facilitating and encouraging corporate risk management with derivatives and not the opposite.

1 *Financial transactions tax: The impacts and arguments. A literature review*, PwC (2013)

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TOO CLO$E TO CALL

THE RACE FOR THE WHITE HOUSE IS FOCUSING THE WORLD'S ATTENTION ON US POLITICS. LEE McDARBY DISCUSSES HOW ELECTION FEVER COULD IMPACT THE DOLLAR

Much like the EU referendum on this side of the pond, the battle for the White House has taken centre stage over in the US this year and will continue to dominate news headlines in the run-up to polling day on 8 November. Whether the Democratic Party retains the presidency – presumably with Hillary Clinton at the helm – or are pipped to the post by the somewhat divisive Donald Trump, the appointment of America's 45th president could significantly impact the US dollar's performance later this year.

Before we contemplate the dollar's post-election future through analysing the precedent set by previous presidential battles in recent history, we should analyse how it has been performing so far in 2016, and consider how the official campaign period might influence its fortunes in the coming months.

With the election still just a dot on the horizon, other more immediate factors held sway over dollar sentiment in Q1 2016. Having strengthened on the whole against sterling – due largely to uncertainty surrounding the UK's referendum vote on its EU membership – the dollar was checked by further downbeat data emanating from China, confirming the fact that the world's second-largest economy remains sluggish. Not to mention, the proverbial icing on the cake of negative sentiment, a renewed slide in commodity prices. This prompted the US Federal Reserve (the Fed) to adopt a more cautious stance in relation to its appetite for further interest-rate increases, after hiking them back in December for the first time since 2006. Such dovish tones from the central bank triggered quarterly losses of around 4% against a basket of currencies.

Since then, however, not only have expectations of fresh US rate hikes gained traction thanks to improved domestic economic conditions after a Q1 lull, developments in the presidential election have begun to focus market attention.

With Donald Trump already confirmed as the Republican presumptive nominee – inching ever closer to clinching the party's official nomination for president after his remaining rivals dropped out of the race – and Hillary Clinton on track to reach the required number of delegates from the primaries to win the Democratic nomination, the ensuing political and economic instability bring uncertainty that could weigh on the dollar in the coming weeks and months. According to several major financial institutions, the dollar could become vulnerable to political rhetoric as both heavyweight nominees trade punches in what could be an open-ended presidential campaign; just as the British pound trended downwards after the UK announced it would be holding its EU referendum.

Historical evidence demonstrates how politics and economics make for intimate bedfellows. The effects of the former on the latter are significant, particularly when the prize is the Oval Office. Prior to the last US presidential election in 2012, the dollar weakened from $1.53 against the pound in mid-January

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to $1.63 in September, with opinion polls predicting the vote as too close to call. At the time, these would have been extremely beneficial conditions if your UK-based business was importing goods or services from the US during this period. For example, at the less favourable January rate, $300,000 worth of stock from your US supplier would have cost £196,000, whereas at the September rate the price would have dropped to £184,000. That constitutes a saving of £12,000 between the high and low points, simply due to fluctuating exchange rates.

Impact post-election

While we don't yet know who will be sworn in as the next US president on 20 January, it goes without saying that whomever comes out on top – Republican or Democrat – the result may well have a significant impact on the US dollar and the financial markets.

The Fed may control the nation's monetary policy, but decisions made and policies implemented by the new president will exert considerable influence over the dollar. If Clinton clinches the election, the impact could be less volatile to the climate of political policy than if Trump seizes power, given that the country has been under the control of a Democratic government since 2009.

If, as headlines suggest, a Trump win engenders a radical shift in policies – including a foreign-policy direction that could potentially isolate the US from its trading partners and have an effect on exports, the resulting market uncertainty regarding its potential impact on the US economy could precipitate exaggerated short-term dollar weakness.

Whether Trump comes up trumps in November or not, it is reasonable to expect that the dollar will experience an initial drop in value to some extent. However, recent history suggests it will recover shortly after some semblance of political and economic stability is restored. For example, when George W Bush was elected into his first term as president, the greenback strengthened against sterling from an average of 1.5150 in 2000 to 1.4500 in 2001. Even more notably, when Barack Obama was first elected, the dollar strengthened from an average of 1.8120 in 2008 to 1.5625 in 2009 versus the sterling.

Managing market volatility

The fluid nature of the FX market and its sensitivity to various political and economic events will be demonstrated by the upcoming US presidential election. This is largely because investors are likely to take flight from the dollar during the campaign period and in the immediate aftermath of the vote, in favour of more stable countries with a relatively strong economic performance in which to invest their capital.

As 8 November draws closer, the prospect of increased dollar volatility will pose different challenges for treasurers of companies that trade internationally, depending on the nature of their international payment requirements. For UK businesses that export to the US, this period of anticipated dollar vulnerability could have an adverse effect on their cash flows, as the cost of their FX exposure escalates.

As a value-added service for SMEs and corporations alike in terms of the management and execution of FX and international payments, an FX expert would help businesses mitigate the risks posed by market movements through the development and implementation of effective FX hedging strategies in line with trading activities. Having taken the time to understand a business's requirements, an FX expert will monitor the currency markets on their behalf, providing specialist guidance around the driving forces influencing their state – facilitating informed decisions around the optimum timing of transfers. By using a specialist in the field of FX and international payments, businesses will gain access to a personal, tailored and proactive service that may not always be offered elsewhere.

> The fluid nature of the FX market and its sensitivity to various political and economic events will be demonstrated by the upcoming US presidential election

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Think before you mingle

IS NETWORKING WORTH YOUR TIME? ONLY IF YOU PLAN, STRATEGISE AND HONE YOUR APPROACH. DARRYL HOWES EXPLAINS

Last year, *Harvard Business Review* published an article that appeared to turn received wisdom on networking on its head, causing consternation among its readership and a wider community of commentators.

For a moment, networking seemed destined for the business back-burner.

The context? On no less a stage than the World Economic Forum, networking supremo, venture capitalist and entrepreneur Rich Stromback (also known as Mr Davos) was said to have uttered a damning indictment of networking, when he argued that our attempts to connect with our fellow man and woman are, mostly, all for nought.

But what Stromback actually said deserves closer analysis.

While recognising the value of high-profile Davos-type events, which offer unrivalled opportunity for face-to-face contact with influential business people, Stromback commented: “Ninety-nine per cent of Davos is information or experience you can get elsewhere, on your own timeframe and in a more comfortable manner.”

Equally enlightening was his response to a question on whether connecting with influencers represents valuable, real work: “The answer is to be extremely efficient and focus on what is truly essential,” he said.

So, how can we increase our networking efficiency and at the same time be open to new methods of connecting for business purposes?

Strategic networking

Networks can take many forms. Heavyweight computing power, coupled with the recent availability of massive social media data sets, show that we are only just beginning to understand how they operate.

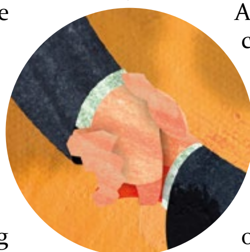
Herminia Ibarra, professor of organisational behaviour at INSEAD Business School, categorises networks under three headings. The first is operational: those relationships required to get our work done. The second is personal, for example, through membership of exclusive groups or affiliations.

However, according to Ibarra, it is only strategic networks, the third and by far the most important type, that can plug the individual into a source of collaborative power that can help drive both individual and organisational goals. Ibarra defines strategic networking as: "the ability to marshall information, support and resources from one sector of a network to achieve results in another".

Since the 1970s, it's been known that exclusive networks, ie those based on traditional social groupings such as school, university or workplace, do not help if we are looking for fresh thinking and inspiration. Stanford social psychologist Mark Granovetter established that 'weak tie' alliances were far better for developing truly useful collaboration. In a modern-knowledge economy, it's easy to see how the 'social superglue' of the former can be usurped by the latter, a form of intellectually lubricating social WD40.

Furthermore, today's time-poor work environment might require us to adopt a new approach to our networking practices. If we don't, we can spend valuable time attending events and building alliances that fail to deliver on our needs. In effect, we'll end up doing the right things, but in the wrong way.

Our start point should therefore be to decide exactly what we want from our networking. How much resource, including time commitment, do we have available to devote to it? What tangible outcomes are we seeking to achieve, and is our normal default mode of connecting with people serving us in the best way?



Disruptive power

The 24/7 digitally connected and disrupted world means we don't have to behave in the same old ways. On the other hand, we cannot sell ourselves (for that is what we are doing) entirely online.

Traditional face-to-face networking always involves a form of honeymoon period. Both parties engage in small talk, get to know each other and build trust. This is a necessary precursor before moving to the separate context of a more formal exchange of business needs, for example, securing that sought-after introduction to a new client or finding a mentor for career development.

But the investment in time required to seek out, research and attend events can prove prohibitive. This is especially so when event organisers are understandably guarded over attendee data and there is no guarantee of the person you want to meet actually being at a given event.

An altogether different approach allows us to find the right kind of contacts using LinkedIn and, where appropriate, orchestrate mutually beneficial introductions via our first- or second-degree connections. This way, building a network becomes less about chance meetings and more about coordinated strategy.

After making a connection, the online small talk aspect can be very helpful, through steady but non-intrusive communication of information that may be useful to a new contact – whether that takes the form of sharing articles, discussion points, general commentary or technical matter.

This is most definitely not spam; the language should be personal and social in nature (it is social media after all) and this practice can be supplemented by LinkedIn's diary features, which highlight work anniversaries, personal events, LinkedIn posts and so on, providing users with a reason and opportunity to reach out.

The communication pathway can be extended further to email or perhaps other forms of social media, such as Twitter. From there, it is a short step to a personal meeting, which is likely to be the key secondary objective. Only here will the conversation be opened out to determine what advice and guidance can be sought. This might be in the form of industry trends, insights or specific assignments that can provide a strategic advantage for the networker.

Traditional face-to-face networking always involves a form of honeymoon period

GRANOVETTER'S 'WEAK TIES'

In a series of experiments designed to understand how people improve their employment prospects, Stanford social psychologist Mark Granovetter interviewed job-seeking participants. He established that, while strong ties breed local social cohesion, they also lead to wider fragmentation. Granovetter claims that a more effective and perhaps more agile networking strategy is to nurture weak ties across, within and beyond our normal close associations. The paradox is that weak ties actually further the integration of individuals among disparate social groups. In short, Granovetter says that weak ties are "indispensable to individuals' opportunities".

Opportunities

It's for all of us to decide on a networking strategy that works according to the resources available to us. But it must be time to consider using a blended range of methods in a more focused and less hit-and-miss fashion.

Social media provides us with new tools and opportunities. If we are to take full advantage of these, we need to consider our network structures and whether we should break out from the exclusive alliances that might restrict our thinking and blind us from a wider range of possibilities.

The final word should go to Stromback: "I need to be selective, yet authentic; focused, yet open to possibilities. Opportunities do not float like clouds in the sky. They are attached to people."

Networking is a social activity, but that doesn't mean it can't be strategic.

Darryl Howes is a learning and development consultant at DDNS Consulting Ltd

TOO GOOD TO BE TRUE

PROFITS WE DON'T UNDERSTAND ARE MORE DANGEROUS THAN LOSSES WE DO UNDERSTAND. DOUG WILLIAMSON EXPLAINS HOW YOUR TECHNICAL LEARNING COULD AVERT A TREASURY DISASTER

Treasury produces financial benefits for organisations, by saving costs and by enabling the commercial activities of the business.

Arbitrage adder

By contrast, chasing arbitrage profits is usually dangerous folly. Arbitrage is very important to define carefully and understand.

Temporary and risk-free

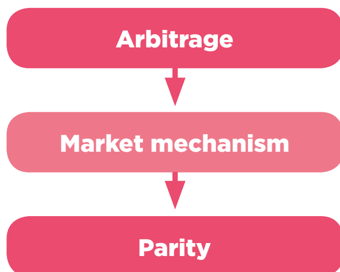
Arbitrage means dealing simultaneously in multiple markets, to exploit a temporary discrepancy in prices, and earn a risk-free profit.

Notice the arbitrage opportunity is both (i) temporary and (ii) risk-free.

No free lunch

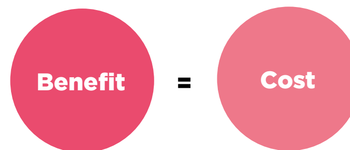
When markets are efficient, any short-term discrepancies in prices, giving rise to temporary arbitrage opportunities, are eliminated by the market mechanism.

Market mechanism



The resulting market condition of 'parity' is known as the 'no-arbitrage' pricing relationship. At the parity prices, there are no longer any arbitrage opportunities. Benefits and costs are equal. This is the 'no free lunch' principle.

Parity



Wolf in sheep's clothing

Disastrous unauthorised speculation has often been misrepresented as 'arbitrage'.

Treasurers need to understand arbitrage for two important reasons. We need to identify:

(a) Rogue trading and other breaches of policy, to eliminate them.
(b) 'Too good to be true' propositions, to decline them.

Not arbitrage

Let's say interest rates in two currencies are:

Currency	C	D
Interest rate	1%	3%

Our boss asks us, "Isn't this a great opportunity to borrow at 1%, deposit at 3%, and earn a risk-free 2% profit: why don't we do it?"

Treasurers are often faced with this kind of question. We need an answer.

"Up to a point"

This is a good way to start answers. It acknowledges the question is half-right. It's certainly true that we could get an interest rate benefit by doing this deal.

But something important has been forgotten.

The hidden cost

There's also a significant cost to the proposition. Namely, an FX loss.

We'd start the deal by borrowing currency C at 1%, and convert it to currency D at the spot FX rate.

We'd simultaneously deposit currency D, to earn the attractive rate of 3%.

At maturity, we need to re-exchange the currencies. To avoid FX risk, we'd need to pre-agree a forward FX rate for the re-exchange.

If the market would ever give us a forward contract to re-exchange at the same FX rate as we enjoyed at the start, we could indeed be better off by the interest rate difference of 3% – 1% = 2%.

Sting in the tail

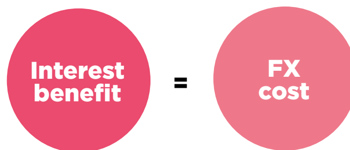
But the market will never do that for us.

Market prices will normally already have adjusted, via the market mechanism, to eliminate any opportunity for risk-free gains by doing these types of 'round trip' deals.

There'll be an adverse difference between the spot and forward FX rates, resulting in an FX loss. Under parity, we lose exactly as much on the FX difference as we gain on the interest rates.

This is known as 'interest rate parity'.

Interest rate parity



Having understood this relationship, we need to explain it concisely to others. Confirm your understanding by answering this recent exam question.

New colleague

Your new colleague has heard you mention arbitrage and interest rate parity, but does not understand what these terms mean.

Explain the relationship between arbitrage and interest rate parity.

Certificate in Treasury, specimen Q23(a), extracts

Outline answer

Arbitrage means dealing simultaneously in related markets whose prices are misaligned, to take advantage of a temporary discrepancy in prices.

Parity is the situation where prices are consistent. Under parity, there are no such risk-free profit (arbitrage) opportunities.

Interest rate parity (IRP) is the expected 'no-arbitrage' price relationship between the interest rates in two currencies, and the spot and forward FX rates.

Assuming more marks and more time, we would write more. The following points would deepen and broaden the explanation for our new colleague.

In practice

Most arbitrage opportunities are short lived and small, because the market mechanism acts very quickly to realign market prices.

If IRP did not hold, a related arbitrage opportunity might be to:

(1) borrow one currency cheaply;
(2) exchange it immediately for a second currency;
(3) deposit the second currency at a higher interest rate; and
(4) re-exchange the currencies at a pre-agreed favourable forward FX rate.

In practice, IRP holds very strongly for widely traded currencies, because of the large volumes and speed of dealing, including arbitrage dealing.

HELP FOR ACT STUDENTS

Download further useful study information from the student site you are assigned to: either the Resources area of the ACT Learning Academy at learning.treasurers.org or the Exam Tips area of the ACT Study Site at study.treasurers.org

Fictional profits

Back in the office, hearing or seeing the word 'arbitrage' should alert us to be cautious and ask questions.

Nick Leeson of the former Barings Bank created unauthorised speculative positions, and misreported them as 'arbitrage' to his managers. Leeson concealed the losses on his speculations, and reported fictional profits.

How to save a billion

The reported profits were too good to be true. These fictional profits were large, persistent and reportedly risk-free. But no real arbitrage opportunity would have lasted that long.

Senior management didn't understand arbitrage well enough. As a result, they didn't ask the right questions. Leeson's disastrous speculations lost his employer well over $1bn, and led to Barings' failure in 1995.

My name is caution

Leeson recently sounded this warning:

> "The message that my name brings is caution. You do need to understand what you're doing, otherwise a lot of people blow up, and blow up very quickly."
>
> *Nick Leeson, 2016*

Lessons to learn

The official report into the failure of Barings included the following lessons:

(a) Management has a duty to fully understand the business it manages.
(b) Responsibilities have to be clearly established and communicated.

To fulfil our management responsibilities, we need to understand.

How to save $9bn

Were these lessons from the Barings failure learned and applied? Evidently not.

Subsequent rogue trading activity resulted in even larger losses, including:

- Société Générale 2006-08: $7bn
- UBS 2011: $2bn

A total of $9bn for those two organisations alone.

Invest study time to understand treasury as deeply as you can. Your organisation needs your insight to prevent the next disaster.

Doug Williamson is a treasury and finance coach

ALAMY

Marx vs Marx

Karl Marx, author of *The Communist Manifesto* and *Das Kapital*, died in 1883. Groucho Marx, comedian, wit and raconteur, was born in 1890. So, of course, they could never have met. But if they had...

"Communism is for us not a state of affairs which is to be established, an ideal to which reality will have to adjust itself," said Karl Marx. He was wandering through Hampstead Heath, absent-mindedly brooding, deep in thought, his brow furrowed. "We call communism the real movement which abolishes the present state of things," he said aloud to no one in particular.

He seemed completely oblivious of the moustached comic striding stooped beside him, his prominent eyebrows raised as high as Karl's were knitted together. "Politics is the art of looking for trouble, finding it everywhere, diagnosing it incorrectly and applying the wrong remedies," said Groucho Marx.

Karl looked to his strange companion as though he had never laid eyes on him before. Which, of course, he hadn't. "A spectre is haunting Europe – the spectre of communism!" he growled.

"Well, whatever it is, I'm against it," said Groucho. "I refuse to join any club that would have me as a member."

"Money is the universal, self-constituted value of all things. Hence it has robbed the whole world of its proper value," Karl said, his humour not improving.

"While money can't buy happiness, it certainly lets you choose your own form of misery," retorted Groucho. "Why, look at me. I worked my way up from nothing to a state of extreme poverty!"

"Have you not read *Das Kapital*?" asked Karl, astonished and angry.

"From the moment I picked your book up until I laid it down, I was convulsed with laughter. Someday I intend reading it," said Groucho.

This provoked Karl no end. From his leather satchel he produced a copy of *The Communist Manifesto*. "Read it!" he roared.

Groucho flicked through the book, his fingers touching the pages as though they might be laced with arsenic. "This is not a book that should be set aside lightly," Groucho concluded a moment later. "It should be flung with great force!"

Karl turned in fury. Before he could speak, Groucho said: "Why, a four-year-old child could understand this. Run out and find me a four-year-old child. I can't make head nor tail out of it."

"Reason has always existed, but not always in a reasonable form," muttered Karl, under his breath.

"Humour is reason gone mad," said Groucho, wagging his finger and his eyebrows. "If you find it hard to laugh at yourself, I would be happy to do it for you."

"The question whether objective truth can be attributed to human thinking is not a question of theory, but is a *practical* question," exclaimed Karl.

Groucho was bewildered. "There's one way to find out if a man is honest: ask him. If he says 'yes', you know he is crooked," he said.

"It is not the consciousness of men that determines their being, but, on the contrary, their social being that determines their consciousness," said Karl.

"Well, everybody's got to believe in something. I believe I'll have another beer," said Groucho.

"What? Are you leaving?" asked Karl.

"I've had a perfectly wonderful evening," said Groucho, "but this wasn't it. And stop pointing that beard at me, it might go off!"

Andrew Sawers is a freelance business and financial journalist. He is a former editor of ***Financial Director*** and has worked on ***Accountancy Age***, ***Business Age*** and ***Commercial Lawyer***. He tweets as @Mr_Numbers

IN THIS ISSUE:

The highlights of the July/August 2016 issue of *The Treasurer* include: Affinity Water's group treasurer, Shaun Kennedy, discusses bond issues and reviews, on page 20. Ways to ensure success when presenting to the board, on page 24. We look at the key stages of a request for proposal process, on page 28. How best to balance the right to privacy in the modern world, on page 34. Can networking work for you? Find out on page 42.

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