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Letter of the Editor   October 4, 2015

Dear Financial Executive,

You receive the **IAFEI Quarterly XXX th Issue**.

This is another issue of the **IAFEI Quarterly**, the electronic professional journal of IAFEI, the International Association of Financial Executives Institutes.

This journal, other than the IAFEI Website, is the internal ongoing information tool of our association,

destined to reach the desk of each financial executive,
or reach him, her otherwise,
at the discretion of the national IAFEI member institutes.

This issue contains a broad variety of articles on accounting, financial and tax matters from 13 countries, respectively country groups, more diversified than ever before, and from very diverse sources.

This issue has again been made more user friendly. From the table of content you can now directly click into every article, without scrolling through the entire issue.

Once again:

I repeat our ongoing invitation, to IAFEI member institutes, and to their members,
to send us articles for inclusion in future IAFEI Quarterlies,
and to also send to us your suggestions for improvements.

With best personal regards

Helmut Schnabel

Australia, Article: Australia Is Closing Tax Loopholes

By **Christoph Hein**, from Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany, September 17, 2015

Singapore, September 16, 2015. Australia is reviewing thousand corporation groups operating worldwide and examines their tax honesty. Should they get caught, of avoiding taxes in Australia, they have to double their tax payments as a punishment and they have to pay interest on the amount.

"The law will cover all multinational corporations which operate in Australia and which have worldwide sales of over one billion dollar ", says minister of Finance Joe Hockey before the parliament in Canberra. For him, it is especially about corporation groups, which are doing business in Australia, but the profit of which they are booking abroad, for instance in Singapore. To this group of corporations belong large mining corporation groups, but also Google and Apple.

Hundreds of millions of dollars might in future flow additionally into the government accounts due to the new regulations. But Hockey refused to mention a sum of additional tax income, because individual cases have to be checked upon first. The highest ranking government tax employee, Chris Jordan, explained, the corporations are already about to change their behavior: "A number of multinational corporation groups are now reporting profits, which previously have not been reported with regard to their business. And they prepare themselves, for restructuring their business in such a way, that they will pay a fair share in Australia."

Jordan was speaking of sales in the amount of hundreds of millions of dollars, which are being achieved in Australia, but which are not being reported in Australia. Australia is taxing corporate profits with 30 percent - significantly more than for instance Singapore, which attracts with many additional tax reliefs.

Australia last year, during its presidency of the G-20-Countries, had agreed with the OECD, Organisation of Economic Cooperation and Development, to proceed in a tougher manner against tax avoidance.

from Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany, September 17, 2015. Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

Nurturing Talent to Promote Treasury Excellence

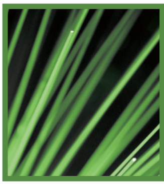
by Jan-Martin Nufer, Director Treasury & Funding, Borealis Group, Austria

Following Borealis' success in winning the 2014 TMI Corporate Recognition Award for Innovation and Excellence in Treasury Transformation, we are delighted to continue the series of articles that outline some of the success factors in Borealis' journey towards treasury excellence, featuring Jan-Martin Nufer, Director of Treasury & Funding.

One of the issues that comes up regularly in discussions with other treasurers is the difficulty in finding, attracting and retaining treasury talent. In some cases, potential candidates lack the right educational background, a problem that is exacerbated by the fact that there is no global standard in treasury qualifications. Another issue is more of a social phenomenon in that entrants to treasury are sometimes unrealistic in their career expectations. While people have clear ambitions, they are not necessarily willing to go through the necessary steps to achieving them. This article outlines some of the ways in which we, at Borealis, have tried to ensure that we attract, retain and motivate the treasury talent that will enable us to deliver excellence to the organisation.

Creating equilibrium in the treasury team

There are inevitably two channels for building a strong treasury team: one, through external recruitment and second, via internal succession combined with talent development programmes and internal training. One of the tools we use is a formal process for succession



Key Points

Measures taken by Borealis to attract, nurture, retain and motivate treasury talent and achieve excellence throughout the corporation include :

- talent, leadership and expert development programmes
- open feedback and evaluation
- detailed succession planning
- deepening talent and experience within the treasury team
- building a consistent culture
- balancing the needs of professionals who intend a career in treasury and those who are gaining treasury experience on the way to a wider career in finance
- ensuring communication across the entire team in all geographic locations

With a clear succession plan in place, we also focus on deepening the talent and experience within the team.

planning. Every position in the team has an incumbent, and a list of people who would be ready to take on the position should it become vacant, either now or after further experience or coaching. At the same time, we recognise the importance of bringing new blood into the team to maintain a healthy balance and introduce new ideas and experience. This is achieved by internal cross-functional moves or external hires. In particular, the cross-fertilisation of ideas from colleagues coming from different business areas into treasury yielded great results. That this is not only feasible but actively fostered is a great asset in our company.

With a clear succession plan in place, we also focus on deepening the talent and experience within the team. This involves coaching, training and providing opportunities for team members to engage with projects that develop their experience, but it is also important to be realistic in matching skills with the responsibilities that we need team members to fulfil. In some cases, a person's abilities or approach may be more suited to a different role within treasury or the wider organisation, or an external appointment.

A culture of collaboration

While developing skills is important, building a positive, consistent culture is also an essential element of talent management. For example, every member of the team should be able to build sound relationships with their peers, managers and external counterparties. This is not simply about negotiating contractual relationships, but demonstrating interpersonal skills to build trust and confidence, and behaving ethically. We base this on the strong framework of our company values: "respect, responsible, exceed and nimblicity" as well as our continuous improvement programme "winning through excellence". For example, credit and collections is managed by treasury at Borealis. There is inevitably a professional natural tension between this function and our sales teams given that objectives can sometimes be in conflict. Consequently, it is particularly important to promote a collaborative culture, communicate proactively and focus on teamwork so that this tension remains creative and fruitful rather than destructive in order to ultimately serve our ultimate company goals in the best way possible.

We evaluate our success in achieving the positive culture for which we are striving though a bi-annual employee survey. We then use the results of this for a large number of initiatives, as well as our talent planning and engagement over the following two-year period. The results of the most recent survey, for example, underlined the importance of being able to manage their own career, hence topics like development, succession planning, including cross-functional skills development to help employees broaden their experience and therefore enhance their career potential.

In addition, one of the points that this dialogue highlighted was the need to balance the needs and aspirations of professionals who intend to build their career in treasury, and those who are developing treasury experience as part of a wider finance career. This also has important implications for the way that the team is structured. While it is unlikely to be appropriate to have all team leaders as part of a finance rotation, it is far more feasible to have one or two or to keep these as deliberate development positions for people joining from other functions who have less treasury experience.

Channelling diversity

The geographic organisation of treasury also has implications for treasury talent. At Borealis, our treasury is cross-functional, cross-cultural and cross-location. Consequently, my focus is on maintaining a common business culture, and to ensure clear, consistent and timely communication across the entire team, wherever they are located. Not only do we prioritise interpersonal skills and proactive dialogue amongst team members, but establishing a common technical platform has also been a vital means of ensuring that everyone shares access to the same data and considers themself to be part of a single team. With the right business culture and technology in place, the diversity that characterises our treasury team works to the advantage of the business, in that people of different cultural and professional

backgrounds approach discussions and challenges in different ways, building a rich decision-making framework that is extremely valuable in a global organisation like Borealis.

One of the ways in which we encourage and foster this dialogue is through various layers of regular team meetings to bring people from different locations together, virtually or physically, including functional sub-groups and the whole treasury team. These meetings allow us to debate challenges that we are facing, share ideas, conduct teambuilding exercises and cascade information throughout the department. We have an open door policy so that people who are interested in topics for which they do not have direct responsibility can stay connected and build knowledge and awareness by attending. One of the most recent idea example developed by the team was a temporary training-on-the-job concept under the title "So you think you can credit", allowing colleagues to work in our environment and understand it in more detail while supporting the workload. We also seek to promote collaboration between teams that work in close proximity so that they understand, and can help facilitate, each other's roles, responsibilities and objectives. For example, we recently held a workshop on treasury, funding, credit and accounts payable that was a significant step in promoting dialogue across teams and increasing treasury's exposure and influence in the wider business.

Performance measurement

In order to evaluate our success in developing talent across our treasury team, we measure individual and team performance. We evaluate individual performance using a variety of tools. For example, we monitor progress against objectives that are agreed as part of a regular appraisal and career development process, leverage human resources tools, and complete the so-called 'finance competence matrix'. This matrix is assessed against each functional role, to ensure that we are supporting each employee in developing the skills that are required for the role, and at the right level or for the next career step. Furthermore, we use various feedback tools like 360 degree feedback, both formally and informally, to take into account perspectives from across the team and outside of our organisation, from our customers and business partners. Like many global organisations, we rank employee performance. This is often very difficult given that the culture of excellence that we espouse in our treasury function, and the high calibre of individuals we attract and are fortunate to have.

Treasury benchmarking

In addition, we benchmark the performance of our treasury function as a whole against both internal benchmarks and third party performance. Some metrics are purely financial, such as financing costs. We also measure the extent to which we are leveraging innovative financing, investment and cash management tools to create value within Borealis. Similarly, we measure the efficiency of our treasury operations, including both quantitative and qualitative measures. In addition, we engage regularly in informal dialogue with other treasurers to understand how they are addressing common challenges and creating value.

While it is relatively straightforward to measure our achievements when using quantitative metrics, qualitative performance is more difficult. Winning independent awards such as the TMI Corporate Award for Innovation and Excellence in Treasury Transformation, 2014 are a very valuable means of demonstrating success and emphasising internally the role that treasury plays in achieving Borealis' strategic objectives. We also participate in independent surveys and studies from time to time, but we find that these occasionally become desktop exercises to benefit the survey sponsor rather than delivering tangible value to Borealis.

Promoting excellence

Identifying, attracting and retaining treasury talent is an ongoing challenge, but we recognise that it needs to remain a priority to achieve the strategic and operational excellence that we are striving for at Borealis. By doing so, we optimise treasury's performance and our ability to contribute to wider group objectives, and create a positive, creative and enjoyable working environment for our treasury team, at all levels and in all locations. We want our team to be proud and excited to work with Borealis and taking a proactive approach to treasury talent management is an essential contributor to this.

In order to evaluate our success in developing talent across our treasury team, we measure individual and team performance.

Scan the QR Code for more treasury case studies on this topic

Borealis

Borealis is a leading global provider of innovative solutions in polyolefins, base chemicals and fertilisers. Headquartered in Vienna, Borealis employs around 6,500 individuals and operates in over 120 countries. It generated EUR 8.3bn in sales revenue in 2014. The International Petroleum Investment Company (IPIC) of Abu Dhabi owns 64% of the company, with the remaining 36% owned by OMV, the leading energy group in the European growth belt. Borealis provides services and products to customers globally in collaboration with Borouge, a joint venture with the Abu Dhabi National Oil Company (ADNOC).

Jan-Martin Nufer

Director Treasury & Funding, Borealis Group, Austria

Jan-Martin is responsible for the Treasury, Funding, Financial Risk Management and Credit & Collections operations of the Borealis Group, which he joined in 2006. Jan-Martin is a graduate from Mannheim University, Germany and a trained banker. He has been working in finance for over 20 years and was with Bayerische Landesbank before starting his career in corporate treasury with VIAG AG (now E.ON). He has worked in the telecommunications (ONE), airline (SWISS) and petrochemicals (Borealis) industries as well as in investment banking and financial advisory.

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Brazil, Article: Brazil in the Downward Spiral

By **Carl Moses**, from Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany, August 18, 2015

The renewed mass protests in Brazil are showing, that Chancellor Angela Merkel is visiting a country in turmoil this week. The economic and political crises are mutually shaking up each other and throw the largest economy in Latin America in ever more intensive turbulences. Brazil is in the heaviest and probably longest recession since decades. After three weak years, the GDP 2015 shall probably shrink by more than 2 percent. For 2016 a further decrease is being forecast. The Real, which has lost a quarter of its value versus the U.S. dollar since the start of the year, is further under pressure by the devaluation in China. When in a while also the interest rates will increase in the USA, then the situation might further deteriorate. Already there is talk about a new "lost decade", like the one in the eighties.

Lost and in a way wasted was also the past decade, which had presented to Brazil, during the raw material boom, a previously not experienced upturn and the blossoming creation of a new middle class. Because, in spite of all the increase in the standard of living, the leftist blue collar worker party PT has missed it, to create a basis for sustained growth and stability. Brazil's worldwide appreciated Expresident Luis Ignácio Lula de Silva had made sure from 2003 to 2010, that this time at least many Brazilians got a small piece of the cake. But his economic model, totally concentrates on the growth of consumption and the internal market, quickly lost its glamour, when the raw material boom came to an end.

Now, when the revenues from the exports of ore and soy beans, are less opulent, the deficits of Lula's politics are showing up - and rather more the mistakes of his politically favored office follower Dilma Rousseff since 2011. Lula had still maintained the three pillars, inherited from his predecessor Fernando Henrique Cardoso - solid budget management, control over inflation by way of interest rate policy, and the flexible exchange rate. But he did not address overdue structural reforms like the streamlining of the intolerable taxing system. The urgently necessary modernization of the infrastructure remained stuck because the government could not manage alone the building of railroads, seaport harbors and power plants, and because it did not offer attractive participation possibilities to private investors. And because the state controlled petrochemical group was overextended with alone operating the new oil fields and with restrictions when building a new local supplier industry, the rise to a global oil power still remains a dream.

Under Lula's successor Rousseff also the stability anchor was removed. The annual government deficit already exceeds 8 percent of GDP. The central bank base rate was lowered too strongly and for too long. Now, when the inflation is advancing towards 10 percent, the interest rate must be raised by so much more. The exchange rate was kept low for too long as well as the prices for electricity and gasoline, in order to artificially suppress inflation. Now, so much more painful corrections are necessary.

Only after her reelection in October 2014, Rousseff did change her economic course, when the exacerbation of the crisis left her no choice. The fact, that Rousseff now allows the Chicago-liberal banker Joaquim Levy as finance minister to execute the austerity policy,

against which she had combatted during the election campaign, is considered by many Brazilians as election fraud.

To all this are now adding the ever larger becoming corruption scandals, which are equally paralising the economy as well as politics. A cartel of suppliers for many years was paying bribery moneys to politicians and officers of Petrobras and other state owned corporations, in order to get overly expensive orders safeguarded. Former managers of Petrobras and the heads of the largest construction firms are in jail. Against dozens of politicians investigations are proceeding. Most of them belong to the parties, which form the coalition government. Permanently new cases are popping up into light. Alone the direct effects of the Petrobras scandal will cost one percent of national economic growth.

The annual government deficit already exceeds 8 percent of GDP.
The central bank base rate was lowered too strongly and for too long.

More dangerous is the standstill of politics. The head of the government, ten months after her reelection, is barely able of acting. Only 8 percent of Brazilians are still supporting Rousseff, two thirds according to a poll even support her impeachment. Necessary savings measures, which would save the creditworthiness of Brazil, are blocked in the parliament, although, theoretically, the government has a majority there. In the discredited cast of politicians, everybody is fighting against everybody. The ones try, to save their skin, the others hope to get a political advantage in the chaos.

In the last days, leading politicians of the governing coalition, seem finally to look for a compromise, in order to stop the threatening downward spiral of the economic and political crisis. After the great hopes of the past decade, though, this presently is only all about limiting the damages.

from Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany, August 18, 2015. Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

INTERVIEW 17.09.2015

Renminbi could rank alongside the US dollar and euro

Interview with Joachim Nagel published in Stuttgarter Nachrichten on 14 September 2015

Interview conducted by Sabine Marquard.
Translation: Deutsche Bundesbank

Mr Nagel, when were you last in China?
I'm in China relatively often representing the Bundesbank. The last time I was there was in March and I'll be flying there again in two weeks. I'm there two to three times a year, on average, mostly for talks with staff of the Chinese central bank and other financial institutions.

Tell us then, when should one use the term renminbi and when should one use the term yuan?
Both terms are used, which sometimes leads to confusion. Renminbi is the name of the currency and yuan is the currency unit. So, for example, a certain amount of yuan will appear on your restaurant bill, but when we talk about the currency as a whole we use the term renminbi.

There is a lot of reporting on China at the moment. Should we care whether China's economy grows by six, seven or nine per cent?
China is Germany's fourth most important exporting country and its second most important importing country. If economic growth weakens in one of our most important trading partners, this can impact on Germany as well. If the Chinese currency appreciates or depreciates, this can affect the price of imports and exports. And, if uncertainty prevails on the Chinese stock markets, this can influence our markets, too. All of this goes to show that China is an important part of the global economy.

Will the renminbi become important for private investors?
I don't exclude this happening in the future. In light of the recent upheavals on the financial market there is currently a certain amount of uncertainty. But the fact is that China is already one of the largest economies in the world. The currency is currently in the process of being opened up, which the Chinese government remains committed to, despite the volatility on the markets.

But the renminbi is yet to acquire freely tradable status.
That's true, but China is working on opening its financial market further, one step at a time. For example, one of its government's key objectives is to fulfil the International Monetary Fund's conditions for inclusion in the currency basket for special drawing rights (SDRs). If this opening process continues, the renminbi has the potential to one day rank alongside the major currencies of the US dollar and the euro.

At the end of last year, Frankfurt became an important trading centre for transactions in the Chinese currency. Who stands to benefit from this?
Since November 2014, it has been possible to settle payments directly between Frankfurt and China. As a result, German enterprises – including small and medium-sized enterprises and individuals with business dealings in China – can settle transactions at much lower costs.

Enterprises can open a renminbi account at the Bank of China in Frankfurt. What are the advantages of this?
In the past, enterprises were usually obliged to settle their Chinese transactions via several financial centres and in several currencies. Now they can open a renminbi account at the People's Bank of China in Frankfurt and settle invoices directly in renminbi. They can settle the transaction in their own time zone, they have contact persons here in Germany and there is less exchange rate risk. Enterprises should increasingly regard this as an opportunity.

You sound rather reserved on the matter.
Not at all. We were very pleased to see Frankfurt become the first trading centre for renminbi in Europe. It's now up to enterprises and banks to exploit this opportunity. However, less than one year in, it's too soon to evaluate its success. All I can do is highlight the advantages to small and medium-sized enterprises with business dealings in China. Recent financial market developments have shown that the renminbi's exchange rate is also not immune to strong fluctuations. If companies now issue their invoices in renminbi, this can reduce the exchange rate risk and avoid considerable costs.

Latterly, the weakening Chinese economy caused stock markets to plummet. Is the Chinese success story coming to an end?
According to official figures, the Chinese economy is still growing at seven per cent per year. This growth roughly corresponds to the annual economic output of Switzerland. After a process of very strong growth spanning two and a half decades, it is not unusual that growth is now slowing. The Chinese are calling the current phase the "new normal".

The speed at which stock markets fell and the volatility are surprising. This is making the rest of the world very nervous. Is this response justified?
It's not unusual for financial markets to react nervously and they aren't a one-way street. China's stock market had made gains of around 150% since the middle of last year before the weaker growth figures became known. The markets have since factored in the "new normal" status to some extent, thus correcting the previous strong rise in equity prices. We need to monitor the situation, but we shouldn't read too much into it either.

Are businesses in Baden-Württemberg getting the most out of the opportunities available in China? You recently said that we needed to make sure that we have a presence there.

In March I attended the Boao Forum on the island of Hainan in the South China Sea. The aim of this conference is to bring together decision-makers in Asia from the fields of business and politics, similarly to the World Economic Forum in Davos. In my view, the German business community had no perceptible presence there. I sense that Germany traditionally feels very strong in terms of its trade with China. Sometimes, having such an attitude leads one to rest too much on one's laurels. German enterprises along with Germany's economic model, which is characterised by a pivotal base of small and medium-sized firms, is held in very high esteem in China. We should regard this as an asset worthy of maintenance.

Will there be rivalry between the euro and the renminbi if the Chinese currency continues its ascendance?

I would tend to see it as a "win-win" situation. Trade flows between Germany and China are almost equal in each direction, with both imports and exports amounting to just over €70 billion. This is a very balanced economic relationship. Both countries have large shared interests and I don't see any rivalry between the euro and the renminbi.

Some people are already calling the renminbi the new US dollar.

The dollar is by far the most liquid currency in the world and is in a different league altogether. This will remain the case for the foreseeable future. However, the renminbi is already one of the five most traded currencies.

Germany, Interview: Asia, Asia, Asia

Where Deutsche Bank's transaction bank wants to grow and where it will invest EUR 1 billion in the next five years.

Interview with Mister **Werner Steinmüller**, head of global transaction banking and member of the group executive committee of Deutsche Bank Group, from Börsen-Zeitung, Frankfurt am Main, Germany, June 23, 2015. Article provided by the German IAFEI Member Institute, the Association of Chief Financial Officers Germany

As part of its **"Strategy 2020",** Deutsche Bank is significantly enhancing its global transaction banking sector. **Werner Steinmüller**, head of the transaction bank and a member of the group executive committee, will be investing EUR 1 billion in the next five years. In this interview with *Börsen-Zeitung*, he explains where the money will go and why the sector is growing, but why numerous systems are to be shut down at the same time.

Mr Steinmüller, Deutsche Bank has replaced its top management. What do you think of that?

I think it is extremely respectable that Anshu Jain and Jürgen Fitschen have told supervisory board chair Paul Achleitner that they are offering up their mandates in the interests of the bank. John Cryan has been on the bank's supervisory board since 2012 and so far I know him from a few meetings. But he asked the right questions there, and this showed that he has a very good understanding of the transaction bank.

Does that mean that nothing is going to change for your division in the context of the Strategy 2020?

You would have to ask John Cryan that. But it's clear to me: the strategy will be implemented.

What's the situation with the co-operation with Stefan Krause, who is now the director with responsibility for the transaction bank following the recent reshuffle on the management board?

It's working very well. I continue to be responsible for daily business in the global transaction bank, while Stefan Krause represents this business at the management board. So we are now two transaction bankers who stand up for the interests of the division in the group executive committee.

As part of the Strategy 2020, you may be putting EUR 1 billion into global transaction banking in the next five years.

At the moment we are investing around EUR 100 million a year in the implementation of regulatory requirements, in new products and in infrastructure as well as IT. This amount is going to be doubled to EUR 200 million on average per year. We will invest that primarily in IT and infrastructure. The number one objective here is highly stable systems. Secondly, the aim is to make our products even better. This involves further automation. The more we are automated, the better use we can make of the possibilities of digitalisation – another area in which we are going to invest. I don't like paper, and a paper-based payment is significantly more expensive than an electronic transaction, which has additional business potential besides. Some 90% of our processes are already automated.

Where will the investments be made specifically?

I can already reveal the general direction of our plan to you: we will modernise the core components of our GTB platform, which we operate in over 40 countries worldwide. Although the existing systems have the advantage of being relatively stable, they are not flexible enough. But the rapid implementation of global regulatory requirements demands flexible systems. We are achieving a flexible system environment by only continuing to operate systems in their core functions and interconnecting the components – these include the current account and all the information that you have to have related to the customer. By doing so, we can then link all the reports that are necessary for the central banks directly to our large number of products. When

you are more flexible, you can act more swiftly, it becomes more cost-effective, and you are more efficient. And, alongside the ability to find structured solutions for the complex requirements of customers, transaction banking also always represents efficiency derived from systems.

> *"I don't like paper, and a paper-based payment is significantly more expensive than an electronic transaction, which has additional business potential besides. Some 90% of our processes are already automated."*

How many systems do you intend to shut down?

Just in terms of access channels – electronic banking is one of those – we still had around 70 different channels not too long ago. Now there are fewer than 50, and the goal is to bring the number down to under 40 in one or two years.

This kind of streamlining makes you more flexible. But it costs money, too, doesn't it?

When you have to maintain significantly fewer systems and monitor their connections to the accounting and to the regulatory side, then that also means a significant reduction in expenditure. This is quite clearly about an increasing efficiency. But what is more important here is the simplification, as we remove complexity.

To what extent?

If you overload systems or if changes are not properly thought through – and every change that you implement has an impact on other systems – then that can lead to disruptions. They impede operations, and they cost a great deal of money. If, at the end of a day, there are transactions we haven't processed, this would have consequences that would also concern the regulator. That is why stability is the number one goal in my eyes. To begin with, costs are a secondary factor. There are customers who choose us because disruptions are rare. A disruption means work for the customer, work for us and more costs. In other words, if we reverse the argument: if you deliver good quality, you can also justify a higher price to a certain extent and reduce your own costs.

Explain to a technical layman how you go about reducing the number of technical systems.

You do it with a clearly defined IT infrastructure, with defined components and clear processes. The two officers responsible for products and IT under my remit have to say: “This is the standard, we want to keep this, but we are going to shut that down.”

And how painful is that?

You can't do it overnight. It’s a continual process. But that is true for the whole of transaction banking, where the cycles are generally very long. For example, if I am trying today to get a major mandate in cash management, it will normally take six months with the tender and the bidding process. Then I will still need another six to twelve months before a solution is implemented at the customer, and it takes up to 18 months before the cash starts to flow. In return, however, we achieve very close, resilient and long-term customer relationships, which is also reflected in our solid earnings.

Where then do you want to put the focus of the investments on the product side?

Payment transaction services are very IT-driven. If you don’t invest in the systems here, you’re going to have problems. We made considerable investments in SEPA and built what is, in my opinion, the best platform in Europe. Meanwhile, in trading finance, it is quite clearly a question of further digitalisation and electronic processing of supply chain financing, in other words classic commercial bills, alongside the documentary credit business. In terms of securities, TARGET2-Securities are very clearly the focus. Although we are not a central securities depository, we will already have direct access to the platform in the first of four migration waves. And the key issue and another top priority for the future is digitalisation.

In future, you will have more money for investments, and the number of systems is set to decrease. What does that mean for the human resources planning? Are you going to hire staff?

There will be a trend for us to need more staff in order to cope with our growth.

How many?

The needs will vary here. In cash management, there is a solution that, as soon as it has been implemented, will run almost automatically, and after that the main focus will switch to service. I cannot automate the area involving letters of credit to a similar degree, so we have to employ more people in processing. It’s the same story in securities processing, where we have acquired major customers with corresponding custody volumes. And we mustn’t lose sight of the fact that, to increase our revenues by 5 per cent, we have to expand our volume by 10 to 15 per cent. Unfortunately, the market has now recognised that transaction banking is highly attractive. And ultimately that means that the pressure on the margins will continue to remain intense in a low interest rate environment.

So you can no longer rely on the obstacles to market entry in your business being too high, on account of the required size and investments, for new competitors to enter the playing field?

Yes and no. We basically have an oligopolistic system. But there are products where it is easier for new competitors to enter the market, for example in the documentary credit business. If a competitor restricts themselves to a country, a region or a part of the value added chain, then they can be successful with that. But, on the other hand, to reproduce our regional reach and to cover the whole process chain end to end as we do is extremely difficult.

> *"If, at the end of a day, there are transactions we haven't processed, this would have consequences that would also concern the regulator. That is why stability is the number one goal in my eyes. To begin with, costs are a secondary factor."*

Will the announced withdrawal of Deutsche Bank from seven to ten countries affect you?

No decision has been made yet on the countries. But the bank is investing in transaction banking and knows that I am marketing a network and that coverage and reach is critical.

To what extent does the planned deconsolidation of Postbank affect your business division?

The customer-oriented transaction banking business is and was separated between Postbank and Deutsche Bank. So in that respect there are no immediate impacts from the deconsolidation on the customer business in my division.

Is it a major project to disentangle this?

That is a question that has to be asked and answered in the context of the deconsolidation, as it may well involve unbundling common technical and operational infrastructures. Today, the two establishments use common IT systems and operating units. If that is to be changed, then the appropriate projects will have to be set up.

You mentioned the pressure on margins from the entry of new competitors. Where then will growth come from in future for your division, especially if interest rates keep on falling?

Let’s start with the regions: Asia, Asia, Asia. In Asia, we achieved 30% gross growth in the first quarter, 10% in local currency. After Asia comes America, where we are growing at a rate of 5% to 6%. So in both regions we are growing almost twice as quickly as the gross national product. I still see a great many opportunities here, not in the country itself – we do not want to compete with the large US providers in their home market – but I am marketing cash management out of the US and trade financing to Asia and Western Europe. This is all developing very well.

You recently delivered a return on equity after tax of 15 per cent, which is above average compared with the rest of the group. Have you already reached the ceiling or can you still top that?

For me, a 12% return on equity is good: that’s a figure I would like to achieve consistently over the long term. The first quarter of this year was the best operating result that we have ever had. That was a positive outlier, but we’d like to have more of them.

What does the cost-income ratio look like?

In the past year, it was 67% and therefore competitive in a tough environment. Incidentally, ratios were an important factor in deciding on investment resources as part of the Strategy 2020.

How great a burden on you are the negative interest rates?

This is a problem, of course. To compensate for that, we have to generate volumes in order to reach the growth we aspire to. And when generating volumes, everything depends on the quality of the IT.

How much higher would earnings be if we had normal interest rates?

50 basis points corresponds to around EUR 100 million. So at 2 per cent we would already be at EUR 400 million– although it must be said that the curve isn’t linear. The first 50 basis points have the biggest effect.

How are you handling the negative rates? Do you charge them to your customers?

Directly passing on negative interest rates is not feasible under German law for corporate customers, so we don’t go lower than 0%. If a customer wants to keep excess liquidity as a demand deposit that will not be used for the operating business, then we suggest alternatives – for example redeploying it in money market funds.

How do you approach customers?

It depends entirely on the customer’s situation, how high the balance is and the daily payment transactions. But it’s obvious that we incur costs for certain deposits, and then we are forced to deal with these costs. That is why we seek dialogue with the customers in these cases.

How do these customers react?

They understand the situation and of course they also want to avoid these costs. So we look for solutions together. Incidentally, it isn't just 20 basis points involved here, it's minus 31: six basis points for the deposit guarantee fund, five for bank resolution – that is the special fund that we now have to create. So we get to 31. And that really is something.

In an interview three years ago, you told us that you want to cut the share of interest-based commission income.

I've been saying that since 2010.

What progress are you making there?

Around 60% of our earnings come from fees and around 40% from interest rates now. Our credit portfolio has grown, because parts of the German SME portfolio are booked with us in the long term and the entire short-term business up to 360 days with corporates and banks is also placed with us. So we also have interest income. Of course it doesn't just involve the euro. 40% of the volume arises outside the eurozone, and on top of that we have the dollar transactions in the eurozone. And then of course there is still interest on deposits.

"For me, a 12 per cent return on equity is good: that's a figure I would like to achieve consistently over the long term."

With the investments, are you also thinking about non-organic growth through acquisitions?

I have learned from experience that focusing on the existing customer groups is the best idea. And for us they are the biggest global banks worldwide. On top of that there are the multinational corporates and major business customers with sales of more than EUR 400 million, who have international requirements. Plus, there's a strong base with SMEs for Germany and the Netherlands, as well as insurance and broker dealers on the banking side.

The last acquisition involved the activities of ABN Amro in 2010. There was a lot of euphoria to be heard at the beginning, then came the increased risk provision in 2012. What does the balance sheet look like now?

A quick reminder: The EU forced ABN Amro to sell parts of the branch network in order for it to be able to merge with Fortis. We had badwill at that time that provided us with extraordinary income. Of course the negative interest rates have gone against us. That is why we have restructured the business division. We have dropped out of the SME business because the risks were too high. We have significantly reduced the branch network and are now concentrating on the middle income sector.

How is the business going now?

Very well, because we are positioning ourselves as an international bank that can also offer simple risk management products. And we are of course also opening up our international network. For example, we are opening renminbi accounts in the Netherlands. The performance of the business in the Netherlands is very pleasing this year, we are also acquiring market share – also because the Netherlands has lacked an international bank. Now we are well positioned, but it was a huge effort. That is why I am cautious when it comes to new acquisitions. Not because of the financial side, but because integrating units of that kind gobbles up a lot of management capacity.

What does your strategy look like in terms of the product range? Are you maintaining your offer?

Products that don't make any appreciable contribution will be reduced or sold, as happened recently with the credit card business. In that area, we realised that we will never be able to overtake First Data or others. We are staying away from anywhere where we don't have core product expertise.

What does "core" mean?

Being among the top 5 in a market or globally. If you don't achieve that, it's difficult to earn money.

How strongly is the market already consolidated? What potential is there for further consolidation?

The competition is enormous, especially in Europe. Here it's a matter of how business is divided up. One of our competitors…

… RBS…

… has just pulled out, and that represents an opportunity for us to acquire market share by impressing customers in search of a new provider with our services. So there are opportunities to grow.

Many of your competitors are disbanding their transaction units. Does that help?

Our competitors have integrated the transaction bank in different business streams and are not as strongly committed to this business. It helps that we are an independent business division, especially as we are maintaining our mentality of process orientation and system solutions, because we know that we are most successful with that. We are sticking to that, and that is another reason why we are acquiring market share. We are also able to attract good new employees and get the best people, because they know that they can pursue a career with us and that the division is taken seriously in the bank. The announcement of our investments reinforces that again.

You focus heavily on service, and service is expensive. Does it also pay off?

Service is critical. We deal with very high turnovers every day, which is why we cannot really have anything go wrong. When problems arise, well-trained people can react quickly and mitigate the consequences at the customers. In an ideal world, malfunctions wouldn't have any direct impact on the customers. Service is an important element of our concept. When it comes to costs, I can only say that the better our systems are, the less service we will have to provide.

This interview was conducted by **Grit Beecken, Bernd Neubacher, Bernd Wittkowski**

About Werner Steinmüller

Systemically relevant

bn – Strategies and bosses come and go at Deutsche Bank, but there has been one constant since 2004: Werner Steinmüller is head of the transaction bank and is therefore responsible globally for the areas of cash management, trust and securities services, trade financing and risk management products. No other sector at the institution attracts less public attention. But Deutsche Bank would still be important in the system if it were to retain only its global transaction banking and sell all other sectors or float them on the stock market: on peak days the transaction bank generates a daily turnover of EUR 4 trillion, a figure that is equivalent to China's currency reserves, the way they explain it in the bank. Stable systems don't hurt here. Born in 1954 and holding a degree in business engineering, Steinmüller started his career at Citibank Germany. The manager, who comes across as pleasantly cool and collected, joined Deutsche Bank in 1991, where he has served among other things as joint head of the Investment Banking division for Germany. He has been a member of the group executive committee of Deutsche Bank since 2009.

Source: Börsen-Zeitung, Frankfurt am Main, Germany, June 23, 2015. Responsible for Translation: Deutsche Bank Group

SPEECH

Frankfurt/Main | 30.09.2015

Dr Andreas Dombret
Member of the Executive Board of the Deutsche Bundesbank

The glass is half full - Seven years of regulatory reform in the financial sector

Keynote Address at the Euromoney Conference "The Public Sector Financing Forum"

1 Introduction

2 A truly challenging environment

3 What's next in financial regulation?

4 Conclusion

1 Introduction

Ladies and gentlemen

Thank you for inviting me to speak at today's Public Sector Financing Forum. It is a great pleasure to be here. The focal point you have chosen for this forum – the low-interest-rate environment – is indeed highly topical, and has been keeping us all very busy lately. A case in point is the survey that the Bundesbank and BaFin recently conducted among German banks on the challenges posed by low interest rates – more on that later.

As you all know, the financial sector still faces a truly challenging environment. While the worst aspects of the crisis and its consequences have been weathered successfully, circumstances remain difficult. In my speech today, I will be discussing these circumstances and also shedding some light on what we have to do to complete the post-crisis regulatory reforms. I will argue that we have come a long way but that we are not done yet. Nevertheless, since we have accomplished the majority of reforms, my message is this: the glass is half full, not half empty.

To the top

2 A truly challenging environment

Before I talk about regulation, let me sketch the truly challenging environment that now exists, and let me emphasise four factors. First, after the crisis, banks faced substantial deleveraging pressure. Adjusting risk taking and funding strategies was necessary in order to survive and meet new regulatory demands. As the process of phasing in the regulatory reforms will continue until 2019, many institutions still need to deleverage further.

Second, all financial institutions – but banks in particular – need to adapt to new technological demands for renewal. Digitalisation offers substantial challenges and opportunities at the same time. In any event, it has the potential to reshape the banking sector.

The third factor is the high degree of investment uncertainty. Unfortunately, in the current economic setting, there remains a high degree of uncertainty about the economic trajectory. What regulators can do, however, is pave the way for a sustainable recovery in the financial sector within a strong framework of rules – and combine this with reasonable phasing-in horizons.

The fourth factor in the difficult environment is the low interest rate setting in which you all have to do business. The recently released results of the joint BaFin-Bundesbank survey indicate that the persistence of low interest rates over a medium to long-term horizon will pose a challenge to the interest-driven business models of many German credit institutions. This is because such a persistently low interest rate environment leads to a structural erosion of interest income as higher-yielding exposures taken on in the past mature and are increasingly replaced by new positions that generate a lower rate of return.

The roughly 1,500 participating credit institutions on average expect pre-tax profits to fall by around 25% by 2019. This would amount to about 2 billion euros each year. In comparison: in 2014, the participating banks realised profits before tax of about 10 billion euros.

Should the period of low interest rates persist, profits would fall by as much as 50% – assuming that the banks leave their balance sheets unchanged. If the level of interest rates went down by another 100 basis points, profits would fall by 60% – provided the banks adjusted their balance sheets. If interest rates increased, profits would stabilise at a level slightly lower than the level realised in 2014.

Given this rather bleak outlook, banks have to act now. They must, for instance, try to increase the share of non-interest income. I have already mentioned digitalisation as a means of benefiting from new business opportunities. The adaptation of business models can generate new customers and streams of income. At the same time, banks should try to reduce costs. Again, digitalisation and the innovation of IT systems can allow significant cost reductions. Another issue on the cost side are the large branch networks of German banks. Here, consolidation might be a promising strategy.

To the top

3 What's next in financial regulation?

Against this challenging backdrop, some may argue that further regulatory reform is a problem, and that it will choke the just recently restarted engine of growth. But let me be clear: all macroeconomic studies on the impact of regulatory reforms are consistent in stressing that the overall economic benefits by far outweigh the costs. And that means that there is no way around fully implementing the reforms that have already been initiated and finalising their outstanding elements.

Having said that, policymakers are very mindful not to impose inefficient regulation and unnecessary costs. In that spirit, regulators took great care in designing the reforms that have already been implemented. And the same is true for those regulatory projects that are still in the pipeline. Some of them are currently under construction, and others are still on the drawing board. Let me outline to you the most important initiatives.

Let's begin with the completion of Basel III, which the Basel Committee is currently in the process of finalising. The new Basel framework marked a milestone in the regulation of banks. No sooner had it been put in place than the Basel Committee set about tackling the variability of risk-weighted assets in portfolios with essentially similar risk profiles. This variability makes it more difficult for investors to compare one bank with another. That is why the Basel Committee is currently overhauling the standardised approaches for credit, market and operational risks. It is also planning to introduce capital floors for internal models based on the standardised approaches. Together with enhanced disclosure formats, this will make it much easier for investors to compare and monitor banks and their risk profiles.

Another fundamental change to the regulatory framework for banks, as I see it, is a revision of the privileged treatment of sovereign bonds. This is another item currently on the Basel Committee's agenda. There is no regulatory or economic justification for such preferential treatment. The sovereign debt crisis that swept across the euro area made it crystal clear just how risky the nexus between sovereigns and national banks can be. That is why the Bundesbank is pushing for government bonds to be backed with a risk-appropriate amount of capital and for large exposure limits, just as they exist for claims on private debtors. We also need to make sure that adequate rules are introduced in the area of liquidity requirements. While I'm certain that tough "political" negotiations still lie ahead, I'm nonetheless confident that the preferential regulatory treatment afforded to sovereign debt will be revised in future. And this will realign incentives and risk premiums to prudent levels.

A third new element is the recovery and resolution regime that has been agreed globally and implemented across Europe. It was created to solve the problem of "too big to fail" banks and to keep taxpayers from having to bear the brunt in a crisis. This new core element of the banking regulation and supervisory framework is currently being finalised on the basis of the guiding principles issued by the international Financial Stability Board, or FSB for short. This resolution regime is a vital step forward in learning one of the key lessons of the financial crisis: the much discussed issue of moral hazard – a problem that arises because institutions that up to now were "too big to fail" could not be held accountable for their actions.

Looking ahead, there won't just be recovery and resolution plans for credit institutions; clearly defined liability cascades will be established, too, so as to ensure that the taxpayer really is last in line to foot the bill – that is to say, after shareholders and creditors have been bailed in, and then only in absolutely exceptional cases. But, to put this theoretical resolution model into practice, institutions will need to hold a certain amount of additional debt which, should the need arise, will be transformed into loss-absorbing capital.

For global systemically important financial institutions, this will be achieved by way of the TLAC standard, which the FSB will finalise this autumn. The same principle applies to the European institutions, but implementation here is based on what is known as the MREL standard, which differs in some respects from the TLAC requirement. One difference is that all institutions will be required to satisfy the MREL requirements, not just the systemically important ones. Another is that the minimum requirements will be set individually for each institution by the competent resolution authority.

These new standards will have a transformative impact on the market for loss-absorbing debt capital. They will introduce attractive new instruments that offer high returns for investors, particularly for those outside the banking sector. And the disclosure requirements under these standards will give investors the transparency they need to make well-founded decisions.

These reforms together with those that have already been accomplished will strengthen institutions' stability and systemic resilience. Nevertheless, when speaking about regulatory reforms, we have to bear in mind that most of those which I have mentioned only affect the regulated banking sector. In the context of low interest rates and tougher regulation, there are incentives for regulatory arbitrage through the shifting of assets from the regulated banking sector to somewhere outside the regulatory perimeter. And we are seeing significant movement in this direction.

That is why the G20 has agreed on a roadmap for regulating the shadow banking sector. Work is being conducted simultaneously by the FSB, the Basel Committee and IOSCO. The objective is to ensure that shadow bank-like risks to financial stability emerging outside the regular banking system are subject to appropriate oversight and regulation. Yet, we are careful not to inhibit sustainable market-based financing models that do not pose such risks.

One good example of a well-designed instrument is the Basel Committee's standard for measuring and controlling large exposures. While Europe had similar rules in place before the Basel framework was published in April 2014, this new standard provides a global approach to regulate relations between banks and other financial institutions. The framework was designed to protect banks from significant losses caused by the sudden default of an individual counterparty. By extending the scope of coverage beyond banks to exposures to funds, securitisation structures and collective investment undertakings, the framework has also become a useful tool in helping to strengthen the oversight and regulation of the shadow banking system.

To the top

4 Conclusion

Ladies and Gentlemen, unfortunately all of us here will have to work in this challenging environment for some time to come – ultra-low interest rates, digitalisation, deleveraging, and a high degree of investment uncertainty will continue to frame our decisions.

Yet, as I have outlined, we are seeing a considerable improvement in the condition of the banking and financial sector. Such developments and the regulatory reforms around Basel III have made the financial system more stable.

Nevertheless, further reform efforts are needed, and the momentum for reform cannot be lost. A resilient resolution regime with sufficient bail-in capital, prudent regulatory treatment of sovereign exposures, and the regulation of shadow banking activities are necessary to make the financial system more resilient.

I think this is good news for investors, because it promises to boost transparency, enhance stability, and generate new investment products.

My talking a lot about outstanding regulatory reforms might give you the impression that most of the work lies ahead of us. Nevertheless, as the title of my speech suggests, we have already achieved a great deal – more than is still ahead of us. As a supervisor, I am happy to say that, while we still have a lot of work to do, the glass is half full, not half empty!

Ladies and gentlemen, that concludes my speech – thank you very much for your attention.

* * *

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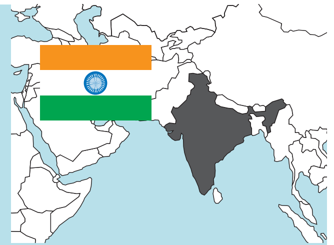
India



Area	3.29 million km²
Population	1.24 billion
Population density	421 people per km²
Gross domestic product	
Total (nominal)	US$1.88 trillion
GDP, per capita (PPP)	US$4,000
GDP growth forecast 2015	6.2%
GDP growth forecast 2016	6.8%
Public debt to GDP	51.8%
Balance of trade (surplus)	US$190.91 billion
Unemployment rate	8.8%

Capital city New Delhi

Main languages Hindi, along with English, Bengali, Telegu and others

Attractiveness of economy to business India ranked 142 out of 189 countries on the World Bank's *Doing Business 2015* report, receiving a high mark for protecting minority investors, yet low marks for enforcing contracts and dealing with construction permits.

Top export markets
European Union 16.7%
United States 12.5%
United Arab Emirates 10.1%

Foreign direct investment
India recorded FDI (net inflows) of US$ 28 billion in 2013, a 17% increase over the previous year. India has FDI caps in certain sectors, including defense, insurance, petroleum and gas, aviation and media.

The manufacturing sector accounts for **59%** of exports

Infrastructure
The country's infrastructure ranked 87 out of 144 countries in the World Economic Forum's *Global Competitiveness Report 2014–2015,* with its electricity supply quality scoring 3.4 on a scale from 1–7 (best), and the quality of its roads scoring 3.8.

Education
In India, 75% of males and 51% of females are literate. The gross enrollment ratio for secondary school is 69%. In 2012, India launched a project to improve access to, and the quality of, secondary education.

63% Adult literacy rate

Legal system
India's constitution was adopted on 26 November 1949, and has since been amended on many occasions. The legal system is based on common law. The president, who is the head of state, and the prime minister, who is the head of the government, lead the executive branch. The legislative branch is composed of the Council of States and the People's Assembly. The Supreme Court is the highest court.

30% minimum corporate income tax rate

Corporate income tax
Resident companies must pay tax on income generated around the world, while nonresident corporations are subject to tax for income accrued in India. The corporate tax rate for resident companies can go up to 33.99%, while the tax rate for nonresident corporations ranges from 41.2% to 43.26%.

Indirect taxes
Depending on the state, value-added taxes range from 4% to 15% on goods. There is also a central sales tax – a minimum 2% – on the sale of goods. Other indirect taxes include a service tax and customs and excise duty.

Other taxes
Interest, royalties and technical services fees are all subject to tax in India. The rate of tax for interest is 10% when paid to domestic companies, and starts at 20% when paid to foreign corporations. The tax on royalties from patents, etc. starts at 25%, as does the tax on technical services fees.

Administration
India ranked 156 in the area of paying taxes in the World Bank's *Doing Business 2015* report. It takes companies 243 hours, on average, each year to prepare, file and pay their taxes in India.

International organization membership
Asian Development Bank (ADB), BRICS, G-15, International Finance Corporation (IFC), Organisation for Economic Co-operation and Development (OECD), United Nations (UN), World Trade Organization (WTO), among others

Transparency International's Corruption Perceptions Index:
38 out of 100 (100 is very clean)

For more information:
Worldwide Corporate Tax Guide 2015

Sources: CIA, World Bank, The Economic Times, UN, Transparency International, EY, WTO, WEF

Mexico

Mexico City

Area	1.96 million km²
Population	120.29 million
Population density	63 people per km²
Gross domestic product	
Total (nominal)	US$1.26 trillion
GDP, per capita (PPP)	US$15,600
GDP growth forecast 2015	3.3%
GDP growth forecast 2016	3.8%
Public debt to GDP	37.7%
Balance of trade (surplus)	US$1 billion
Unemployment rate	4.9%

Capital city Mexico City

Main language Spanish

Attractiveness of economy to business Mexico ranked 39 out of 189 countries on the World Bank's *Doing Business 2015* report, receiving its highest marks for getting credit and resolving insolvency.

Top export markets
United States 78.9%
European Union 5.2%
Canada 2.7%

Foreign direct investment
Mexico recorded FDI (net inflows) of US$35.2 billion in 2013, a big increase over 2012 as economic reforms attracted investors.

The manufacturing sector accounts for **75%** of exports

Infrastructure
Mexico has launched a US$590 billion infrastructure plan, targeted at the energy sector (new gas pipelines and power plants), as well as the transportation sector (a new airport, a high-speed rail project and an expanded fiber optic cable network). Mexico's infrastructure was ranked 65 out of 144 countries in the World Economic Forum's *Global Competitiveness Report 2014–2015.*

Education
Mexico has a literacy rate of 93.5%. The percentage of adults aged 25–64 who have a high school degree is 36%. Mexico has introduced a series of reforms in recent years in a bid to improve the quality of its education system.

93.5%
Adult literacy rate

Legal system
Mexico's current constitution was approved on 5 February 1917, with many subsequent amendments. The legal system is based on civil law. The president heads the executive branch, while the Senate and Chamber of Deputies make up the legislative branch. The highest courts are the Supreme Court of Justice and the Electoral Tribunal of the Federal Judiciary.

30%
Corporate income tax rate

Corporate income tax
Resident corporations are subject to tax on all worldwide income, while nonresident companies must pay tax on income derived from doing business in Mexico. Only the federal government taxes corporations.

Indirect taxes
Mexico has a 16% value-added tax (VAT) on goods and services, excluding exports. There is also a 5% residence tax on the salary of each employee.

Other taxes
There is a 10% income tax on dividends paid out to shareholders (both residents and nonresidents). If the earnings were already subject to corporate income tax and the company has enough in its "net tax profit" account, then no corporate income tax is paid on the dividends.

Administration
Mexico ranked 105 in the area of paying taxes in the World Bank's *Doing Business 2015* report. It takes companies 334 hours, on average, each year to prepare, file and pay their taxes in Mexico.

International organization membership
Asia-Pacific Economic Cooperation (APEC), G-15, Inter-American Development Bank (IADB), Organisation for Economic Co-operation and Development (OECD), United Nations (UN), World Trade Organization (WTO)

Transparency International's Corruption Perceptions Index:
35 out of 100 (100 is very clean)

For more information:
Worldwide Corporate Tax Guide 2015

Sources: CIA, World Bank, The Economic Times, EY, WTO, UN, WEF, OECD, Transparency International

New Zealand

New Zealand may be regarded as a 'safe haven' economy, but its treasurers still have plenty of risks to manage, says Mahesh Chhagan

Geographically isolated and occupying a lonely spot near the bottom of the globe, New Zealand is probably best known as Middle Earth. In fact, few things are more iconically Kiwi than Hobbits and our patriotic devotion to our unbeatable national rugby team, the All Blacks. But believe it or not, New Zealand, distant from most of its trading partners, has also become known for its dynamic, bustling, export-orientated, high-growth economy.

New Zealand's economic growth and employment levels have outpaced most other developed economies since 2012. Strong growth, record inward migration and elevated export commodity prices led the Reserve Bank of New Zealand to tighten monetary policy in 2014, while most of the world's developed economies were still in recession or early recovery.

Prices for the country's main export commodity, milk, have recently fallen dramatically from the record highs of 2013, however. Furthermore, the New Zealand dollar has fluctuated markedly, reaching highs above 0.8800 against the US dollar in mid-2014 and lows of just above 0.7000 more recently (a 20% depreciation). Likewise, long-term New Zealand interest rates have traversed a 2% range. In short, New Zealand has not been sheltered from the global volatility headwinds.

Auckland, New Zealand's largest city

PHOTOGRAPHY: SHUTTERSTOCK

New Zealand relies heavily on external trade as a source of revenue. Exports accounted for 29% of GDP in 2014. Yet, despite being the 54th largest economy in the world, it has the 10th most commonly traded currency, which is often targeted by currency speculators due to its high volatility. Greater levels of private indebtedness require relatively higher interest rates to attract a constant flow of international investment. As a result, local organisations are exposed to numerous global risks and market forces. Hence, risk management is a major concern for almost all New Zealand organisations.

Treasury matters

Recently, PwC published the results of its 2015 *New Zealand Treasury Management Survey*. While the survey is New Zealand-focused, many of the key findings may have global relevance – particularly for SMEs.

The survey results are broken down into eight key themes:

- Governance and policy issues;
- FX risk management;
- Interest rate risk management;
- Commodity/energy price risk management;
- Investment criteria;
- Funding and bank relationships;
- Hedge accounting treatment; and
- Treasury management systems.

This article covers some of the high-level findings from the survey. But the survey does delve into some granular detail, so if you would like further information, you can get it by downloading the publication from http://tinyurl.com/qeet3nh

The governance section of the publication highlighted that, despite the complexity of risks that treasury functions are managing, most organisations (83%), particularly in the small- and medium-sized categories, have one or less full-time equivalent treasury staff member.

Surprisingly, the result is higher even than that observed in the 2011 survey, where

Country file

Population size: 4.57 million
Geographical area: 268,021km^2
% GDP growth in 2014: 3.5%
Median age: 29.8 years
Type of govt: Constitutional monarchy
Official languages: English and Māori
Capital city: Wellington **Largest city:** Auckland
GDP (2013): $182.6bn
Central govt debt as a proportion of GDP (2013): 35.9%
Currency: New Zealand dollar (NZD)
Currency rate against the euro: €0.60

it came in at 67%. We expected the global financial crisis and subsequent events to have resulted in a greater realisation by boards of the scale and importance of risk that understaffed treasury functions are managing. One possible explanation for this trend could be the treasury advisory and outsourcing services that exist in New Zealand, where specialist external advisers and treasury outsourcing functions are available to fill the void.

Respondents were asked about their organisations' overall approach to managing FX and interest rate risks. For the purposes of this survey, the following options were provided:

The passive approach: The mechanical hedging approach to exact percentage limits that involves no active management (ie limited scope for discretionary decision-making).

The active approach: Dynamically increasing or decreasing hedging levels and/or shortening/lengthening the hedging horizon within policy limits where hedging decisions rely on factors influencing the market price movement of market FX and interest rates (for example, macroeconomic, correlations between different products, etc).

Not managed approach: No hedging is entered into with derivatives, but a material risk is present.

The majority of New Zealand organisations are actively managing their FX and interest rate risks. This is interesting for two reasons. Firstly, New Zealand organisations operate with an understaffed treasury function, yet the majority of these organisations actively manage their risks. Hedging under an active framework is a complicated activity that requires substantial resources. Deciding if one should hedge, how much to hedge, what choice of instrument to use, where to place the maturity of this hedging and also when to hedge (ie timing) is a complex process.

History has shown that derivative usage, coupled with a lack of expertise, can result in material trading losses, which ultimately could be a value-destroying proposition for an organisation. New Zealand organisations may be able to cope with extreme values over a short horizon, but over longer horizons, these extremes may lead to profitability and competitiveness issues. Management, therefore, has an obligation to protect the shareholders' interests from these adverse risks and thus, risk management is becoming more strategically focused.

Forward exchange contracts for FX risks and interest rate swaps for interest rate risks are clearly the favoured derivatives. New Zealand organisations overlook optionality. Such findings may be explained by the difficulties associated with hedge accounting for options or volatility movements. The lack of optionality may also be due to a lack of understanding. The decision to use forward exchange contracts or interest rate swaps over an option is often because of the upfront premium payments associated with options. The use of optionality should consider the premium costs in points, break-even analysis and the potential participation benefits.

Funding and liquidity

The funding and bank relationship section of the survey also produced concerning results. There are questions over whether New Zealand organisations are becoming too comfortable with their funding and liquidity risks.

We found that the majority of organisations surveyed are sole-banked and comfortable with this position. In addition, there seems to be a heavy reliance on bank funding, particularly for organisations with low and medium debt levels. This signals an over-reliance factor. Evidence also suggests that there may be a declining appetite for longer-term debt funding. This comes as a surprise given the fall in New Zealand credit spreads.

The current environment suggests that it is more advantageous to lengthen tenor. Developments in the New Zealand debt markets have seen the availability of longer-term debt at credit margins lower than before the global financial crisis. Respondents also indicated that it is easier (or, at least, not harder) to obtain funding than it was two years ago, which may be the reason for the observations made in this section.

New Zealand organisations should consider spreading their funding sources over multiple counterparties, not only to introduce competition (and hence possibly favourable pricing), but also to remove the concentration risk. Organisations should look to extend debt maturities, not only to take advantage of historically low credit spreads, but also to ensure that they have long-term commitments secured.

Good practice is a key theme drawn upon throughout the publication. This involves having procedures and policies in place that promote effective risk management. It entails making continuous enhancements to the organisation's risk management approach and capabilities as opposed to being overwhelmed by the need to make a transformational change following a crisis. It's about planning ahead and identifying areas of focus and priorities for investment, whether this entails the implementation of a new treasury management system, reviewing the treasury policy or digging deeper into specific areas such as FX risk.

FIVE TOP TIPS FOR DOING BUSINESS IN NEW ZEALAND

1. **Be conscious that, as an export-oriented economy, New Zealand has a heavy reliance on its major trading partners and, therefore, has a significant exposure to global market conditions.**
2. **New Zealand has a population of just 4.5 million people, so if your business requires critical scale, it may pay to bear this in mind.**
3. **New Zealand is predominantly an agricultural nation (apparently there are more than 20 sheep to every person). Accordingly, there are massive opportunities and demand for innovation in the agricultural industry.**
4. **Due to New Zealand's small financial market and a tight financial community, building a long-standing reputation for integrity matters.**
5. **If you're not wearing black on the night of an All Blacks test match, you might as well declare bankruptcy.**

Conclusion

Over recent years, New Zealand organisations and their treasury functions have dealt with financial markets that have been consistent only in their unpredictability. The nation's heavy reliance on external trade has meant that its economy is significantly exposed to global market conditions. Treasurers have had to tackle concerns surrounding their exposure to these volatile markets, which has been crucial for New Zealand's economic development.

New Zealand organisations are exposed to risks that have the potential to be vastly material and hence it is important that they devote the resources necessary to manage these. Treasury management should continue to be a major concern for every organisation, and risk management ought to rank highly on the boardroom agenda.

Mahesh Chhagan is a treasury analyst at PwC, based in New Zealand

OECD, Article: Credit Scarcity is Slowing Down Euro-Countries; Outlook Americas, China

By **Christian Schubert,** Frankfurter Allgemeine Zeitung,
Frankfurt am Main, Germany, September 17, 2015

Paris, September 16, 2015. The growth in the **Euro-Area** is improving slightly, but it remains far below its potential. The OECD, the Organisation for Economic Cooperation and Development, in its newest economic outlook, makes especially the credit scarcity responsible for this, which only very recently has tapered off a little bit.

In spite of the monetary easing by the European Central bank, ECB, a lower oil price, and the weak Euro, the recovery is almost not getting off the ground, states the chief economist Catherine Mann on Wednesday in Paris. Growth in the Euro Area will increase in the coming year only from 1.6 percent to 1.9 percent. In the past year, the OECD had still expected a growth for 2016 by 2.1 percent. For the slowing down, also the slowing down in China is responsible, from which also Germany is suffering.

The German economy is therefore said, to only grow by 2 percent in the coming year - not any more by 2,4 percent, as the Organisation OECD was still assuming in June.

The consumption of the households in the Euro Area is now stagnating in the Euro Area already since 2008/ 2009, is complaining the OECD. Capital expenditure by the corporations is said to even be 15 percent lower than before the financial crisis. “Only in Germany we see a tiny improvement at the capital expenditures”, said Mann.

Also in Spain, overall, a positive development can be observed, even though unemployment is still high.

In Italy, it is said, the reforms of the labor market are beginning to have effects.

The slow recovery in the Euro-Area does the OECD contrast to the good development in the **United States of America**, where capital expenditures and consumption are said to have recovered. In this year the economy there will grow by 2,4 percent like in the previous year, and it will then slightly accelerate to 2,6 percent in 2016. According to the chief economist Mann an essential difference is the decrease of indebtedness of American households and corporations. In addition, the American banks have written off bad debts to a much higher degree than the European financial corporations.

One reason of the blockade of Europe is said to be the fragmentation of the European markets. What is needed is a repair of the credit channels. To this belongs a banking union, a joint deposit protection scheme, a uniform supervision and the write off of bad debts, said Mann.

As to the expected interest rate increase in the United States of America said Mann, that the timing is less important than the degree of increase. In this context she was also referring to the risks of the emerging market countries.

In the USA, banks have written off bad debts
to a much higher degree
than the European financial corporations.

For **Brazil** the OECD is expecting a decrease of the GDP by 0.7 percent in the coming year, after it had still expected, in June, a growth by 1,1 percent.

For **China,** the OECD is expecting a lowering of the growth rate from 7,4 percent to 6,7 percent in this year, and to 6,5 percent in 2016.

from Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany, September 17, 2015. Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

Chasing payments

THE NUMBER OF DEBTORS IS CONSTANTLY GROWING AND SO IS THE NUMBER OF BAD DEBT LOSSES SUFFERED BY COMPANIES. WHY DON'T BUSINESSES SETTLE THEIR BILLS ON TIME? MAŁGORZATA WEJER EXPLAINS

Since 1989, fundamental changes have revolutionised the economic, political, legal and social systems in Central and Eastern Europe, and the former Soviet Union countries.

One of the advantages to these countries of entering a free market was that their companies were able to do business transactions without having to make immediate payment. But these new market rules, which were introduced in the emerging countries, caused several problems, including the onset of overdue payments.

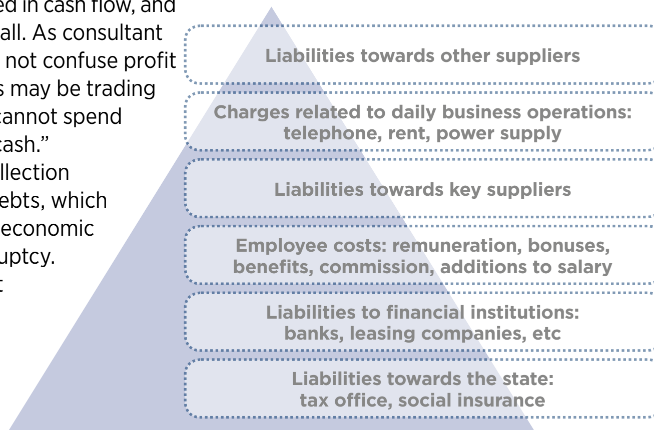
In Poland, around 43% of all business transactions are currently made on credit, out of which 30% are overdue. In other Eastern European countries, the proportion of uncollectible debts is 32%, whereas for Western countries it is 37.6%. From east to west, the most frequent reasons for not paying on time are insufficient availability of funds and the use of invoices as a form of financing.

Many companies that have failed recently would have looked very prosperous if just their sales value and turnover were taken into account. Yet, the profits resulting from an increase in receivables were not reflected in cash flow, and this presents a lesson to us all. As consultant Charley Swords puts it: "Do not confuse profit with cash – while a business may be trading profitably, remember, you cannot spend profit, you can only spend cash."

Failure to initiate debt-collection procedures results in bad debts, which can plunge companies into economic crisis and, ultimately, bankruptcy. Entrepreneurs are often not aware of the consequences of outstanding payments, which include the cost of lost opportunities, debt-collection costs and costs remitted to the state treasury for every transaction. Shorter recovery time guarantees smaller losses for the company. When a company is in financial difficulty, every day of a delay in recovering receivables can play a decisive part in determining whether the business continues or not.

Currently, almost all business-to-business transactions are made on credit, with terms of payment varying. Yet the reasons for overdue receivables are nearly the same in every business sector. One of the major reasons for this is that a company's source of funds is limited, which forces it to prioritise its payables. If the company does not have enough money, it starts to choose among its suppliers, beginning with the strategic ones. If a company is short of resources for day-to-day payments, this may be a result of its chosen order of settling liabilities, which could follow the pattern shown below.

First, companies make payments to the state authorities, which, in the case of late payments, charge penalty interest and quickly initiate recovery procedures. Debtors are afraid of the state institutions, so they have a considerable predominance over others.



Next, there are those payables to financial institutions, mainly banks and leasing companies, that are related to operating activities and allow the entrepreneur to realise key company objectives. Again, the business cannot afford any stops in production or delivery service because of the consequences of overdue payments: the institutions may cancel the contract immediately.

Employee benefits, liabilities to strategic suppliers and payables for day-to-day operations

HOW TO MANAGE LATE PAYMENTS

1. **MAKE IMMEDIATE CONTACT** with the debtor to ask when the overdue payment can be expected. Send the final notice outlining all the payment details. Remember that time is king, especially in debt collection, since research conducted in EU countries has shown that where a payment is three months overdue, the chances of recovering the receivable are 75%. This drops to 50% after six months and 25% after one year.
2. **WITHHOLD THE DELIVERY** until the payment is received. Get everyone involved. Overdue receivables are not just an issue for financial managers; sales managers can be very effective in terms of collecting debts and stopping the debtors' purchases.
3. **COMMENCE LEGAL ACTION.** Invest in a good legal adviser to help you to investigate your receivables in the court and to commence execution proceedings.
4. **WRITE OFF THE DEBT.** The company may write off the receivables on the basis of probability of recovery in certain circumstances, such as:
   - *receivables from debtors who are in bankruptcy or in the midst of a liquidation process;*
   - *receivables from debtors whose request for bankruptcy was dismissed by the court;*
   - *questioning of receivables by debtors; and*
   - *due or overdue receivables for which recovery is very doubtful.*

are ranked third and fourth on the list because late payments bring no severe consequences. In the case of payments to staff, some employers will assume that people can wait.

Fifth come payables to suppliers of the basic services needed to run a business, for example, gas, energy and telephone providers. One of the reasons why these providers rank fairly low on the list may be the fact they apply ineffective collection procedures.

Last in line are liabilities to suppliers, whose trade credit helps businesses to finance themselves without incurring penalty interest for a delay. So, if your company is not a strategic supplier and does not represent a state organisation, you have to be prepared to wait for payment for a long time. Ironically, the fact that this situation is allowed to exist is probably a result of many entrepreneurs having effective debt-collecting procedures.

While the problem with uncollectable debts applies across Europe, the reasons why companies do not pay differ from west to east. I have chosen one country – Poland – to juxtapose the average results in Europe with those of an exact country.

According to the results (see above), the most frequent reason for delayed payment was insufficient availability of funds. Polish respondents also blamed complexity of the payment, as well as inefficiencies of the banking system, which the other European respondents did not concur with to the same degree. The other worrying reason for overdue payments was the inaccuracy of the information put on the invoice. This simple matter is a typical problem for Polish businesses. It is worth mentioning that a significant proportion of Polish market players use trade credit as a way of financing their businesses. This suggests that overdue payables are a practice commonly used by Polish entrepreneurs.

MAIN REASONS FOR PAYMENT DELAYS BY DOMESTIC BUSINESS-TO-BUSINESS CUSTOMERS

	Eastern Europe	Western Europe	Poland
Insufficient availability of funds	58.6%	46.6%	51.2%
Dispute over quality of goods delivered or service provided	11.1%	16.7%	8.0%
Goods delivered or service provided do not correspond to what was agreed in the contract	9.5%	13.2%	12.9%
Complexity of the payment procedure	11.3%	18.0%	19.9%
Inefficiencies of the banking system	10.4%	17.8%	23.4%
Incorrect information on invoice	11.5%	16.2%	18.4%
Buyer using outstanding debts/invoice as a form of financing	30.0%	29.3%	35.3%
Formal insolvency of the buyer (liquidation, receivership, bankruptcy)	25.0%	20.5%	29.4%
Invoice was sent to wrong person	8.2%	12.7%	11.0%
Other	10.5%	6.7%	2.5%

Source: Atradius Payment Practices Barometer – June 2014

Better late than never

In order to minimise the level of overdue receivables that they have, companies could monitor all of their payments on a regular basis.

The perfect tool to help managers control the outstanding accounts is an ageing schedule that presents a company's invoices and its due dates, usually in a table format. Another method is checking days' sales outstanding, which gives an approximation of the average age of accounts receivables. These techniques inform managers of the current financial standing of the company, so they can promptly initiate its debt-collection procedure.

Once this procedure is initiated, the first step would be to investigate why the customer did not make the payment and check when this overdue payment can be expected. All employees involved in the business transactions should know that deliveries to that debtor will be withheld until the payment is received.

It is paramount that the business's legal adviser be engaged at this stage. If there is no possibility of collecting the receivables, then the accountant should write off the debt, allowing the creditor to adjust previously accrued tax.

Conclusion

The above-mentioned reasons for not paying on time should serve as a warning against the growing number of overdue receivables. The perfect solution for businesses would be to avoid overdue receivables altogether, but this is almost impossible. If your business struggles with an increasing number of bad debts, then all of your actions should lead in one direction: effective and immediate debt collection.

Małgorzata Wejer is an academic business and financial teacher. She is a member of the Polish Corporate Treasurers Association. Contact her at malgo.wejer@gmail.com

Russia, Article: Russia Wants to Build Up Its Own Rating Agency

The Objective is the Independence from the U.S. Rating Agencies

By cet., from Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany, August 4, 2015

Moscow, August 3, 2015. Now, also Russia has jumped on the train of such countries, which regard the dominance of the large U.S. rating agencies as a danger. A body of the Russian Central Bank decided at the end of June, to establish an own rating agency for the examination of the creditworthiness of debtors during the fourth quarter 2015, which also withstands "geopolitical risks". The agency could issue in spring 2016 the first ratings about the creditworthiness of banks and corporations - at first only in Russia, later in the Eurasian Economic Union, an association of formerly Soviet states, under the leadership of Moscow.

The phenomenon is known: As long as Standard & Poor's, Moody's Investor Service and Fitch Rating do issue positive evaluations about debtors, then these are satisfied with them. But if the evaluations become more critical, then especially states consider themselves as being attacked and they suspect political games. Large institutional investors often make it dependable from the Evaluations of the three rating Agencies, whether or not they invest in the bonds of a country. S&P's and Moody's have lowered, this year, the rating of Russia into the socalled speculative grade, the "non-investment-grade". At this point, for many investors, the wheat is separated from the chaff. Fitch is still maintaining the lowest investments grade category, but is gives Moscow a negative outlook.

> *As long as Standard & Poor's, Moody's Investor Service and Fitch Rating do issue positive evaluations about debtors, then these are satisfied with them. But if the evaluations become more critical, then especially states consider themselves as being attacked and they suspect political games.*

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Now, many do regard the analyses and evaluations by S&P and Moody's with scepticism. Here it is about the default probability of bonds of the Russian Central State. On the one hand, the government budget is suffering from the economic crisis and will finish the year with a deficit, but the state indebtedness with 20 percent of GDP is still low. Also, Moscow has demonstrated, that it is acting very cautiously towards international investors, when it comes to financial market issues. So, as well in the financial market crisis, as well as in the present market turbulences and the most recent Russian Rouble crisis, no capital controls have been

introduced. The ongoing promise, that this will remain so, is often viewed as one of the few credible statements of the kremlin.

It is a habit, that the issuers of securities do pay for the creditworthiness evaluations, issued about them, and that they give orders to issue them. This creates potential conflicts of interest.

In Russia this will not be different, but another point weighs heavier: The new Russian agency is intended to belong to the issuers.

The equity of 3 billion Russian Rouble (44 million Euro) is targeted, to be contributed by banks, insurance companies and other financial market participants. No shareholder is said to be allowed to own more than 5 percent of the agency. In a first round, interested shareholders can now apply till end of August. If not enough money will be solicited, then the central bank will provide the remaining equity capital - but as has become known, the pool of investors has been formed by and large. So the second largest Russian bank VTB shall participate, a financial institution controlled by the state, which repeatedly has been beneficiary of state capital infusions.

It is the investors, that is the creditors, who, by accepting creditworthiness evaluations, decide about their credibility. There are doubts, about whether international investors will accept the new Russian rating agency with a view to how it is being established. And Russian investors, at least those who are close to the Russian state, shall buy domestic debt obligations without a new label (apart from the fact, that there already do exist a hand full of smaller rating agencies in Russia). Even the head of Russia's railroad is having doubts, whether the participation of issuers among the shareholders of the new rating agency is a good idea

from Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany, August 4, 2015. Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

Many of the countries in which we operate are still emerging economically, with varying degrees of regulatory restriction and currency controls.

An Entrepreneurial Approach to Centralisation at AkzoNobel

by Jarno Timmerman, Head of Treasury South East Asia Pacific, AkzoNobel Treasury & Investor Relations

AkzoNobel has a centralised approach to treasury management, with a regional treasury centre (RTC) based in Singapore with responsibility for Asia Pacific, apart from China, Hong Kong and Taiwan which are supported through a dedicated treasury function in Shanghai. The RTC supports between 110 and 120 entities across 20 countries, covering cash management, foreign exchange, risk management, internal and external financing and investment.

Gaining a market appreciation

When I joined the Singapore RTC 18 months ago, the difference in doing business in Asia compared with Europe was very striking. While Europe remains troubled by economic stagnation and uncertainty, the atmosphere in Asia is very positive and entrepreneurial. Even so, many of the countries in which we operate are still emerging economically, with varying degrees of regulatory restriction and currency controls. While this issue is

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well-known to treasury professionals worldwide, it is often difficult to appreciate the extent to which these restrictions differ by country and the varying levels of maturity in each country's economic development and financial infrastructure without being 'on the ground'.

Regulators in each country take a distinct approach to regulatory change, which is important to understand. In India, for example, it is common for rules to be established and then adapted. In Indonesia, there is more of a tendency to pilot changes, and then reverse or amend them depending on the outcome. These cultural, economic, regulatory and infrastructural differences, and the pace and nature of change, create completely different dynamics for managing treasury in Asia compared with Europe.

A pioneer in payments

Prior to my arrival, AkzoNobel had put in place regional cash management mandates for its business in Asia with two banks, HSBC and Deutsche Bank, which we have now finalised and implemented. This has included putting in place a payments factory, which covers both open and restricted economies, which is unusual amongst corporate treasuries. We have our own SWIFT address, so we have full access to the banking network and have set up robust interfaces between our internal SAP infrastructure and our partner banks, which has led to highly efficient and secure transaction processing.

In liberal countries (such as Singapore, Australia and New Zealand) we process payments on behalf of group entities ('payments on behalf of' or POBO). In more restricted countries, we still collate and process payment information centrally using a single platform, but payments are executed through the relevant entity account. Our payments factory is also distinctive in that we have configured our systems to process local payment instruments and formats as well as electronic fund transfers based on standard formats, enabling us to meet the needs of each entity as comprehensively as possible.

There are a few payment types that we are obliged to treat as exceptions, such as payroll and statutory payments in some jurisdictions which have specific data requirements, and in some cases we need to process these through local banks. However, only 5-10% of payments in Asia are treated as exceptions while the remaining payments are processed by HSBC or Deutsche Bank. As regulations in each country evolve, we are able to adapt the way that we support the relevant entities, and we can connect additional entities into the structure.

Our payments factory has been instrumental in reducing costs and improving efficiency and control, but also improving our business intelligence, such as cash flow forecasting. We focused on building a 'state of the art' payments factory from the start, and it has proved not only one of the most valuable, but also the most interesting element of our in-house bank structure. This is particularly the case in more complex economies which are now moving into scope as regulatory conditions evolve.

Extending centralisation to trade finance

Having successfully centralised bank relationships and standardised transaction processing for cash management, we have now set out to achieve similar benefits in trade finance. Previously, trade finance activities, such as letters of credit and guarantees, were managed locally by each entity, resulting in fragmented relationships and inconsistent, inefficient processes and controls. We worked with each entity to understand its trade finance needs and created a request for proposal for a regional trade finance mandate. Our objective was to standardise our trade finance activities and processes, reduce costs and enhance efficiency and control.

We appointed HSBC as our partner bank, and we are now implementing our new trade finance strategy across Asia. AkzoNobel NV borrows under a single facility, as opposed to each entity borrowing locally, and then allocates a credit limit to each entity. Local finance teams then connect to a single platform to access financing and execute transactions within the agreed credit limit agreed with treasury.

Overcoming challenges

One of the most significant challenges in implementing a centralised approach has been cultural rather than technical. The AkzoNobel Group has traditionally operated as a loose alliance of small and medium-sized enterprises, with a high degree of autonomy and an entrepreneurial culture. As the size of each entity, and the number of entities within the group has grown, however, this approach is not longer viable, and we needed to standardise and streamline our activities to maintain our competitive position. The challenge was how best to foster the entrepreneurial spirit that AkzoNobel's employees value, whilst encouraging support for greater centralisation.

We debated how best to encourage financial controllers and local finance teams to use a central platform: for example, while we could have enforced compliance through treasury policy, these entities are remote from the group's headquarters, so we decided it would be better to work closely with financial controllers to articulate the benefits rather than imposing compliance from afar. This approach also enabled us to access local expertise to understand and adapt our systems and processes to support specific needs in each country. HSBC has also been very helpful by engaging with local entities as well as group treasury: indeed, the bank's coverage, local network and expertise in working at multiple levels within client organisations were amongst the factors in our selection.

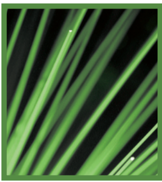
Monitoring progress

Although we are at an early stage in standardising our systems and processes, and rationalising bank relationships, the

Key Points

- AkzoNobel has now finalised and implemented regional cash management mandates for its business in Asia with HSBC and Deutsche Bank
- A state of the art payments factory has been established
- HSBC has been appointed as the company's partner bank for a new trade finance strategy across Asia, in which AkzoNobel NV borrows under a single facility
- The author summarises the challenges and benefits of the new systems, and describes the firm's approach to the centralisation of FX risk management

We decided it would be better to work closely with financial controllers to articulate the benefits rather than imposing compliance from afar.



By telephone. However, by connecting FXGo with SAP, we achieve the benefits of straight-through processing with better price discovery.

implementation is proving highly successful. A number of entities already had connections with HSBC, which has been very helpful in building trust and confidence. In these cases, the first step has been to convert contracts to the standard group-wide template that we have in place, and then onboard each entity in turn, which will continue throughout 2015.

Looking ahead

Having made considerable progress towards centralising payments, cash management and trade finance in Asia, with a robust base from which to extend these activities in the future, the next major area of focus is FX risk management. In some cases, namely convertible currencies such as SGD, HKD, AUD and NZD, these are hedged through the in-house bank at our group treasury centre in the Netherlands. For restricted currencies, we currently hedge FX exposures locally, with financial controllers approaching their bank directly. As FX risk management is only part of their role, and the number of transactions may be relatively small, it is typically easier to approach their cash management bank, rather than obtaining competitive quotes.

We decided that it would be better to centralise FX risk management in order to ensure the necessary degree of specialist skills, reduce costs and increase processing efficiency and control. Under a new procedure, business units will advise treasury of their hedging requirements via SAP, and the RTC will then collate the relevant exposures, and route these automatically to authorised banks via Bloomberg FXGo for competitive bidding and transaction execution. This approach remains relatively unusual amongst corporations in Asia. Many companies choose to do auto-dealing of FX exposures with their cash management bank through the bank's platform, or deal manually by telephone. However, by connecting FXGo with SAP, we achieve the benefits of straight-through processing with better price discovery.

Pursuit of excellence

In addition to the major centralisation projects in which we have been engaged, we have a constant focus on optimising our financial and operational efficiency. For example, we are working closely with our treasury centre in Shanghai to determine the best means of integrating RMB into our regional and global liquidity management structures. Similarly, now that our cash management mandates are fully operational, we are now looking to refine the solutions and services in each country to ensure that we are benefitting from optimal performance from our banks, and delivering the best possible service to group companies. □

Jarno Timmerman
Head of Treasury South East Asia Pacific, AkzoNobel Treasury & Investor Relations

Jarno Timmerman has over 13 years of treasury experience with multinationals in the airline, apparel and chemicals industry, covering cash management, financial risk management, financial markets, trade finance, corporate finance, treasury accounting and control and M&A. He currently heads the South East Asia Pacific Treasury hub for AkzoNobel in Singapore.

Jarno holds a university degree in Economics and a post-graduate degree in Treasury Management, both from the University of Amsterdam, The Netherlands.

AkzoNobel

AkzoNobel is a leading global paints and coatings company and a major producer of specialty chemicals. Calling on centuries of expertise, the group supplies industries and consumers worldwide with innovative products and sustainable technologies designed to meet the growing demands of our fast-changing planet.

Headquartered in Amsterdam, The Netherlands, AkzoNobel employs approximately 47,000 people in around 80 countries, with a portfolio that includes well-known brands such as Dulux, Sikkens, International, Interpon and Eka. In 2014 AkzoNobel generated revenues of €14.59bn.

UK,
Interview: Hybrid Bonds are Considered as an Oasis in the Yield Desert

The Bond expert forecasts continued growth of the market for hybrid capital. Also corporations, which are not having a rating, are increasingly using this instrument.
Interview with Mister **Matthias Minor**, Royal Bank of Scotland, from Börsen-Zeitung, Frankfurt am Main, Germany, August 22, 2015.

Hybrid bonds have a firm place in the European corporate bond market. Ever more corporations - even those without a rating - are using these bonds for refinancing purposes. **Matthias Minor** from Royal Bank of Scotland in London, UK, in the interview by Börsen-Zeitung, is attesting good perspectives to this segment.

Q: Mr. Minor, the first time hybrid bonds were seen in the market was between 2003 and 2006, with the next wave of issuance in 2009/2010. Now we see the third generation of hybrid bonds. Can hybrid bonds already be considered an asset-class of its own in the fixed income market?

A: Yes, without a doubt. In the foreseeable future we expect the 100th company to issue a Euro hybrid bond. We also expect the outstanding amount to exceed the EUR 100bn threshold. Both numbers are impressive and indicators of the enormous growth of the hybrid bond market in recent years. The strong interest of a large share of fixed income investors for these higher interest-bearing, subordinated instruments plays an important role in the current low interest environment. Ten years ago only about 20% of institutional fixed income investors were investing in hybrid bonds, whereas now more than 80% are investing. In addition we see private investors with a growing interest in this asset class. Hybrid bonds are considered as an oasis in the yield desert.

Q: What are the characteristics of a hybrid bond?

A: A hybrid bond has three key characteristics: longer maturities, the option of the issuer to defer interest payments, and subordination to senior ranking liabilities. The latter can, in case of insolvency, lead to higher loss absorption. In the market we see perpetual hybrid bonds and hybrid bonds with a maturity of between 30 and 60 years. Usually, there is a call date at which the issuer can buy back the bonds at par. If the hybrid bonds are not called by the issuer, coupon payments typically increase - usually by a total amount of 100 basis points. The requirements of rating agencies, tax authorities and accounting regulations – especially IFRS - , are important factors throughout the structuring process of the transactions.

Q: Which industries and which regions are among the main issuers?

A: In the first two generations of hybrid bonds utilities accounted for the majority of issuance, with a share of more than 80%. Nowadays we also see a lot of industrial companies who are considering issuing hybrid bonds as part of their strategic corporate financing. In the Euro currency the industry split is currently 31% utilities, 17% telecommunications, 10% each energy and automotive, and 8% pharmaceuticals.

Q: What are the main currencies?

A: European companies focus on hybrid capital in the Euro market. In the past five years about 70% of issuance of European issuers was denominated in Euro. Volkswagen for example already placed Euro 7.5bn of hybrid capital in the Euro market. On the other side, issuers are also using the strong investor appetite for subordinated financing in other currencies. 15% of all transactions in the past five years were denominated in USD and about 13% in GBP. Swiss companies often issue hybrid bonds in their domestic CHF market.

Q: What are the main reasons for issuing hybrid bonds?

A: Hybrid capital is now established as a cost-effective financing instrument, which helps stabilise the credit rating, especially in cases of debt financed acquisitions or investments, which could lead to weaker credit ratios. Under these circumstances hybrid bonds have

become an important refinancing tool. Most recently, we saw Bayer and Merck in Germany who used hybrid capital for M&A refinancing. Also privately owned companies like Bertelsmann were able to successfully place this equity-like instrument. Corporates also use hybrid capital in order to decrease pension deficits in a cost efficient way. This may be relevant in the current environment of lower interest rates and higher pension provisions, which have put pressure on credit ratios for numerous German companies. Also negative macroeconomic influences like a low oil price can be a reason to issue hybrid capital in order to strengthen the balance sheet. This was the rationale for French energy company TOTAL, which issued EUR5bn of hybrid capital in February of this year.

Q: Which are the advantages for the issuer in relation to ratings?

A: Rating agencies treat hybrid capital partly as equity. They view it as a long-dated, permanent feature of the capital structure of a company. When calculating debt ratios hybrid bonds of investment-grade companies usually receive 50% equity credit. But there are also hybrid capital structures with higher equity recognition. Issuers work closely with their banking partners in relation to the communication with rating agencies and throughout the structuring process of the instrument. Former concerns, hybrid capital could just be a short-term market phenomenon have not materialised. The large number of hybrid bonds that were placed and rated in the market should give confidence to corporates that this instrument will also be available in the future.

Q: In the pricing process reference is made to the so-called subordination premium. How would you describe this feature?

A: The subordination premium is the difference in credit spread between a hybrid bond and a comparable senior bond of the same issuer. It describes the additional interest that an investor can obtain via a subordinated, more risky investment. As an example: in the investment grade segment, hybrid bonds usually have a rating, which is two notches lower than senior bonds. Therefore, investors in the current market are compensated with a premium of ca. 200-300bps (2- 3%).

Q: Are there also non-rated companies issuing hybrid capital, and what is the rationale behind this?

A: Indeed there is a growing number of non-rated companies which draw on hybrid capital to improve their capital structure. This year alone four European companies Air France, Eurofins, Sainsbury and German VTG placed more than EUR 1bn of hybrid capital in the market. The main driver for these companies is the equity recognition under IFRS. This is why the hybrid securities of companies without a public rating usually are issued with a perpetual maturity. Many investors show interest in these non-rated hybrids. The credit-story plays a key role in the investment decision process.

Q: How did the market develop on the investor side?

A: Many institutional investors have become more comfortable with the product over the last couple of years. One of the main reasons is the attractive return that the instrument can offer to investors. The last transactions we brought to the market – Bayer, RWE and Bertelsmann – also saw the typically strong investor interest from Germany and the UK. Both regions

combined usually account for more than two-thirds of investor demand. Strong investor interest is usually seen from fund managers, insurance companies and private banks.

Q: Have companies protected themselves in relation to tax aspects when structuring hybrid instruments?

A: Hybrid bonds usually contain a call option, which - in case interest payments are not tax deductible anymore - gives the issuer the right to buy back the bonds at par or at 101%. Similar call options exist for a change in equity recognition by either the rating agencies or under IFRS. In case one of these call events is triggered the company will consider whether it would best to exercise the call option from an economic point of view. In addition, market participants expect issuers to consider their reputation in the market and how a possible buy-back would be viewed by investors, also considering prevailing market prices.

Q: We are now approaching the first call dates of the 2009/2010 issuances. How is this progressing?

A: In total 15 hybrid bonds of the first and second generation have their first call date either this or next year. Investors, just like rating agencies, pay special attention to these dates. Vattenfall, Dong, Bayer, Suez and RWE have already exercised their call right this year. All of these companies issued new hybrid bonds as so called "replacements". Only Südzucker did not exercise its call option, which resulted in an increase of the annual coupon of 100 basis points (1%).

Q: Which further developments do you expect in the hybrid segment?

A: Hybrid capital established itself as an own asset class in the market. According to our assessment, this instrument can be advantageous for both issuers and investors. On both sides we expect a growing number of market participants, on the corporate side this also includes companies without a credit rating. In Germany, the issuance volume of 2014 was five times higher than in 2013. 2015 could be another record year, provided t the market environment remains stable.

This interview was conducted by **Kai Johannsen**

About Matthias Minor

Matthias Minor is Head of Corporate Coverage and Debt Capital Markets - Germany, Austria, Switzerland , The Royal Bank of Scotland (RBS) in London. Since 2002 he has supported companies with strategic capital market transactions. Most recently he led as responsible Managing Director hybrid capital transactions for Bayer, RWE and Bertelsmann. Prior to joining RBS he was at Lehman Brothers in New York and London where he worked in M&A, Corporate Finance and Leveraged Finance. Matthias graduated from Wissenschaftliche Hochschule für Unternehmensführung (WHU) in Koblenz.

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IAFEI Executive Committee Meeting, IAFEI Board of Directors Meeting, October 13, 2015, Milan, Italy

45th IAFEI World Congress, 2015, Milan, Italy, October 14 to 16, 2015

Hosting IAFEI member institute is the Financial Executives Institute of Italy, ANDAF

46th IAFEI World Congress, 2016, in Russia

Hosting IAFEI member institute will be the Russian Club of Financial Directors, RCFD
Location, and exact time, not yet determined.

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