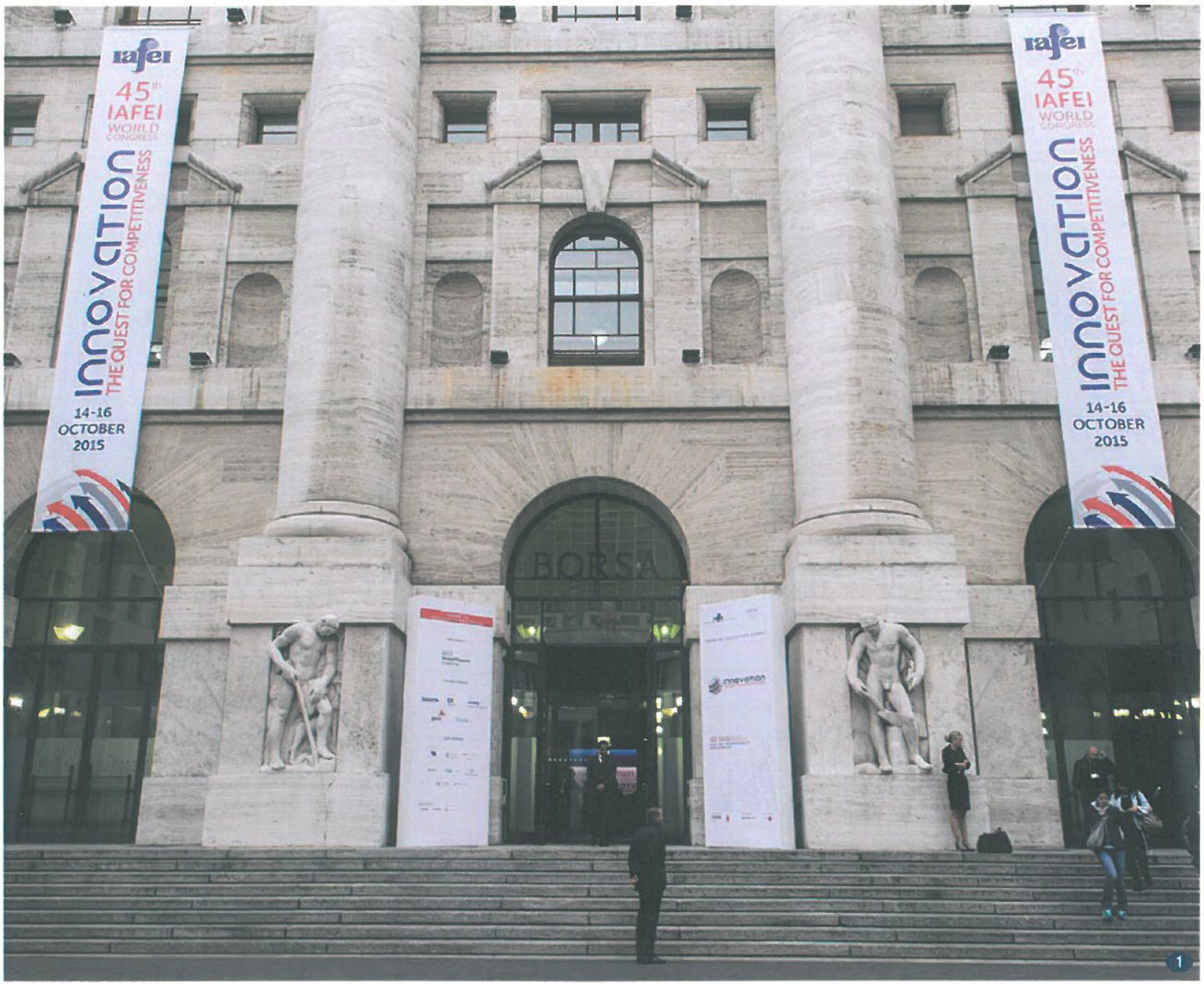
IAFEI Quarterly

The Electronic Professional Journal of IAFEI Issue 31 / January 2016



Milan, Italy, Palazzo Mezzanotte - Borsa - Italian Stock Exchange, location of 45 th IAFEI World Congress, October 14 to 16, 2015

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Dear Colleagues,

I am most honoured to have been elected Chairman of IAFEI as of January 1st 2016.

My first thoughts are to send very warm thanks to our past-chairman Luis Ortiz Hidalgo for his enthusiastic and professional leadership over the last three years, which has brought significant progress visible to all.

Indeed, in the last few months we have gained new member institutes representing CFOs from Tunisia, South Africa, Argentina and Brasil, and several others are currently in the process of adhering to our organization.

These new members are most welcome as we spread our representation globally, including for the first time institutes from Africa, a clear sign of the globalization of the economy in every area of the planet. Today IAFEI represents over 15,000 CFOs operating in 20 countries worldwide.

The primary objective of the newly elected IAFEI Executive Committe is precisely that of increasing the importance and the representative image of IAFEI on the world stage, and strengthening its role in the economic and financial environment which is the focus of interest of our associates.

To reach this objective, we must strengthen the IAFEI Technical Committees, whose role is considered strategic for the development of our association in analysing the different rules and laws which regulate the economic and financial activity worldwide, identifying and disseminating the best practices, and creating the foundations for increasing the professional expertise of our members.

Another part of our plan must be to increase the value and the quality of our IAFEI QUARTERLY magazine, and to this end we have started by installing an Editorial Board and a Chief Editor. The latest edition already has some interesting new features, and work will continue to make the format a successful must read for all our associates.

Let me take this opportunity to wish each and every one of our members a happy and successful 2016, in every corner of the world!

Fausto Cosi

Letter of the Chief Editor January 14, 2016

Dear Financial Executive,

You receive the **IAFEI Quarterly XXXI st 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 marks a new start for the IAFEI Quarterly. This new start has been backed up by the IAFEI Board of Directors decision of October 13, 2015, to establish an Editorial Board consisting of 10 IAFEI representatives from all continents. See the respective chapter of this Quarterly.

This issue contains a broad variety of articles on accounting, financial and tax matters from many countries, respectively country groups, and from very diverse sources.

This issue again has the more user friendly format, introduced last summer. From the table of contents 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 each of 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

Helmut Schnabel


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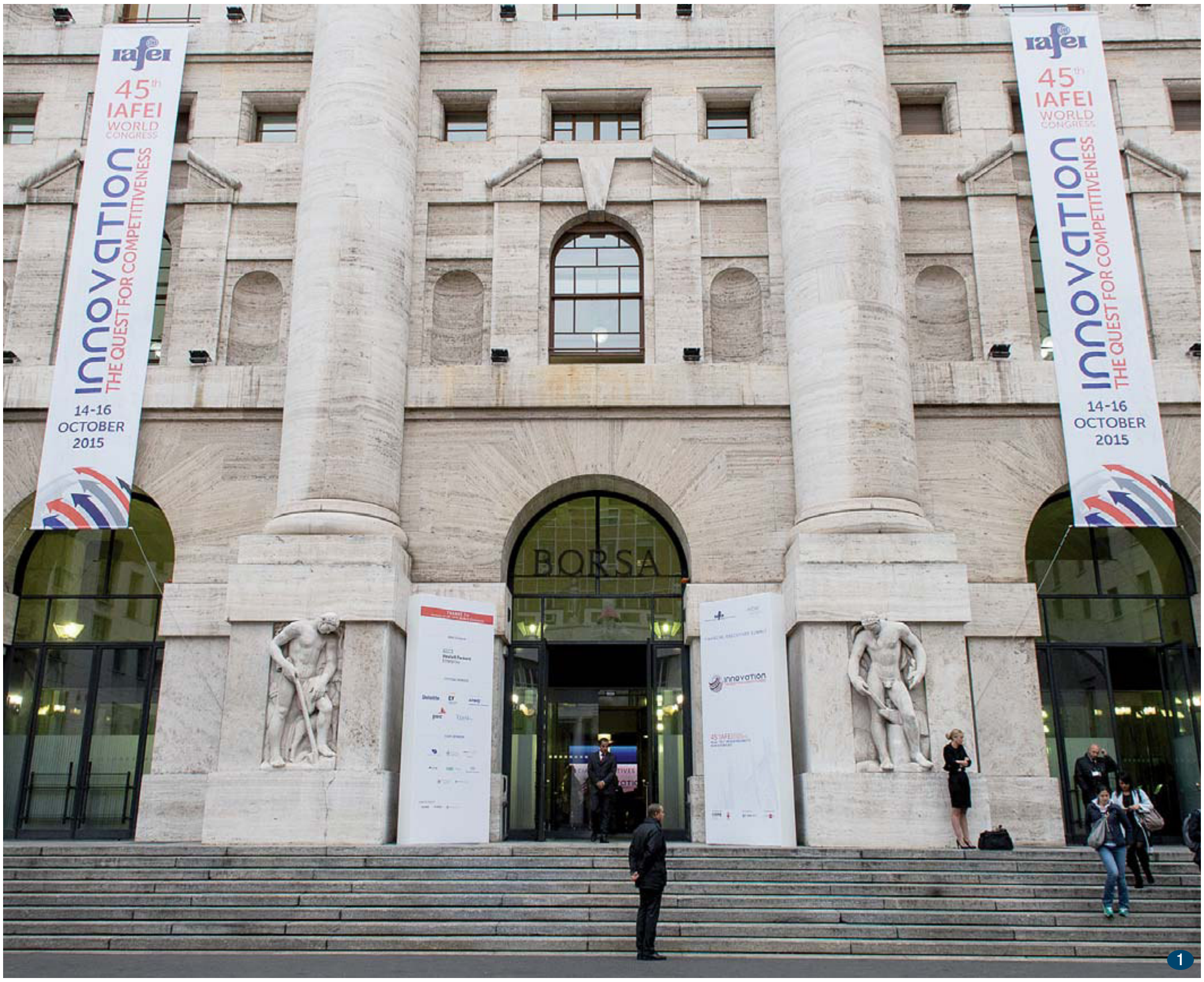
45TH IAFEI WORLD CONGRESS

INNOVATION: THE QUEST FOR **COMPETITIVENESS**

MILAN 14-16 OCTOBER 2015

IMPROVING COMPANIES' COMPETITIVENESS THROUGH THEIR CAPACITY TO INNOVATE. THIS WAS THE CENTRAL THEME OF THE 45TH IAFEI WORLD CONGRESS ORGANISED BY ANDAF IN MILAN FROM 14 TO 16 OCTOBER 2015. THE WORKS OF THE CONGRESS CAN BE CONSULTED IN FULL ON THE ANDAF WEBSITE (AS A VIDEO), BUT, AS IS TRADITIONAL, WE PROVIDE A SHORT SUMMARY IN THESE PAGES



1. Palazzo Mezzanotte hosted the 45th IAFEI World Congress; 2. Fausto Cosi, Vice Chairman IAFEI and Chairman ANDAF; 3. Gabriele Fontanesi, IAFEI Organizing Committee Chairman; 4. Filippo Barberis, Councillor Municipality of Milan; 5. Luis Ortiz-Hidalgo, Chairman IAFEI; 6. the Congress is about to start

PAOLO BERTOLI
Editor in Chief ANDAF Magazine

"He who fails to innovate is lost"

In a constantly developing economic and social context, which is governed by new rules and new players, "he who stops is lost". When the level of competitiveness is high, what makes the difference is the ability of entrepreneurs to innovate. However, innovation must be a concept which goes beyond the production of goods and services, it must embrace a broader viewpoint: it is necessary to innovate processes, business models, the very way of being a CFO. This is the sense of the introductory speech by ANDAF Chairman, Fausto Cosi, who said that, from this viewpoint, he was confident about the future of the Italian economy. *«There are signs,»* said Cosi *«that mean we can be optimistic: the rationalisation programs implemented by companies over recent years are producing positive results, just as the Government's reforms, for example the Jobs Act, are helping companies reduce production costs and encourage the recruitment of young people. In short, in Italy the most serious stage of the crisis seems to be behind us, and there has been a kind of natural selection. However, now is the time to look forward and return to investing, above all, in innovation».* Cosi was echoed by the IAFEI Chairman Luis Ortiz-Hidalgo, *«Also for IAFEI innovation is paramount»* he recalled, *"with a view to introduce new services for its members, such as the five commissions which have been created over recent years: the International Financial Reporting Standards (IFRS) Committee, the International Treasury Committee, the International Tax Committee, the International Observatory of Management Controller Committee and the Anti-Corruption Committee».*

__7.__ Roundtable Cloud - The no Land Economy; __8.__ Romano Prodi, Economist, former European Commission President and Prime Minister of Italy; __9.__ Fabrizio Saccomanni, Former Minister of Economy and Finance of Italy; __10.__ Lunch Time; __11.__ James Hogan, President and CEO Etihad Airways and Vice Chairman of Alitalia; __12.__ Michael Wale, President EAME Division Starwood Hotels & Resorts Worldwide Inc.; __13.__ Marina Natale, Deputy General Manager UniCredit Group; __14.__ Alessandro Ovi, Publisher and Editor MIT Technology Review

A call to innovation as an essential lever for competition was also made by Gabriele Fontanesi, IAFEI Chairman and head of the Congress organising committee, who, in his welcoming address, underlined how *«every economy must try to always be competitive. Innovation and competitiveness must be all-round imperatives»*.

Globalisation: the global economy and its trends

«It's impossible to conceive of a modern economy without innovation». So started, almost seamlessly with the introductory speeches, former Prime Minister Romano Prodi who, in the opening substantive speech to the Congress, focussed on the changing world and the risks for markets. According to Prodi, the challenge for the global economy will be China: *«The economy is rotating around China, which has increasing influence on the international markets»*. Prodi then recalled that Beijing has chosen the London Stock Exchange to list its own currency, the Renminbi, a sign of the internationalisation of Chinese finance. The slowdown in the Chinese economy is a worrying sign given that the global economy is growing, but very slowly, at 2.9% in 2015 according to the forecasts presented by Prodi, lower than the IMF's prediction of 3.1%, while Europe will not do better than 1.4% as it is affected by the Germany risk following the Volkswagen scandal. Given these uncertainties and the low level of inflation, Prodi said not to expect *«the end of Quantitative Easing before the end of 2017»*, nor in September 2016 as announced by the ECB.

Regulation and growth

The need for a new approach to banking and financing regulation was addressed by Fabrizio Saccomanni, Director General Emeritus of the Bank of Italy and former Minister of the Economy and Finance. *«Since the start of the global crisis,»* he said *«banking and financing regulation has generally intensified and global growth has been disappointing. There are 'fault lines' in the international monetary system causing global monetary and financial instability to the detriment of growth. The global crisis has left us with slow growth and low inflation, with risks of 'a century-long stagnation' and deflation: for this reason expansive monetary policies have been adopted. The G7 and emerging countries have adopted different approaches, which have led to inefficient management by the International Monetary Fund. Therefore, a new approach is necessary, based on consultation and monitoring procedures, which would form the basis of a multilateral guide to cover both interest and exchange rates, with the aim of minimising the risk of destabilising impacts and financial cycles. This should allow a reduction in the level of regulation, with the aim of promoting its simplification and rationalisation.»*

Innovate in a global sector: the case of aviation

«Aviation is global, not local,» James Hogan, the Chairman and CEO of Etihad and Vice President of Alitalia made immediately clear in starting his talk. *«Etihad Airways has only existed for 12 years. Our main competitors have been flying for decades, even for generations. They have mature networks, large fleets, a global presence and market access. Some traditional competitors are aggressively trying to block our growth»*. Yet, Hogan went on, *«the combined force of Etihad Airways, with its seven equity partners and its partners in codeshare, has created a network of around 600 destinations". According to Hogan "in order to compete effectively, we need economies of scale and differentiation»*.

Innovation in the global sector of hospitality

Michael Wale, Chairman of the EAME Division of Starwood Hotels&Resorts Worldwide, stressed how essential it is, for the hospitality sector (which can generate in just one year turnover of 6.5 billion dollars, 10% of global GDP), that innovation is combined with maximising customer satisfaction. *«The types of travellers are continually changing,»* Wale said, *«to the extent that in order to satisfy them all we*

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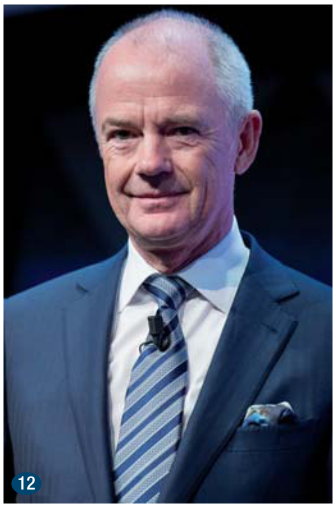

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have created 10 different types of hotels, 10 different lifestyles». It is essential to follow, for example, the innovations in the TLC sector, given that with the advent of mobile telephony there has been very rapid development which has produced apps, websites for bookings, but above all how important blogs and forums have become for the exchange of qualitative information and opinions.

What about banks?

Marina Natale, Deputy Director General of UniCredit, addressed the issues of banks, their degree of competition and innovation, and the forces that are remodelling their identity after the years of the crisis. *«The crisis that as from 2008 has hit the global economy has caused several 'victims'»* she explained *«but there is no doubt that it is the banks which have suffered the most. The question now is: what are the areas on which it is necessary to work in order to remodel the banking system?»* She indicated four of them: regulation (which must find the right balance between rigidity and necessity), customer behaviour (who are now more risk adverse, more price sensitive and have less trust in banks), technology (key factor in innovation and therefore competitiveness, as well as an instrument that can provide customer satisfaction) and competition.

Cloud: opportunities and threats of immateriality

The first roundtable of the Congress was that which addressed one of the most revolutionary technological innovations of recent years: the cloud. What possibilities does cloud computing provide? What are the concerns? These were the questions put by the moderator of the meeting, Piergiorgio Valente, Managing Partner of GEB Partners, to the participants. Alberto Pera (Partner, Gianni Origoni, Grippo e Partners, Former Executive Secretary Italian Antitrust Authority) stressed the legislative issues affecting this sector, highlighting that currently there is no system of unanimous laws, because each country has its own laws, even if the problems experienced are the same: that of protecting data above all. Adriana Berrocal, Managing Director, BValue Consulting, on the other hand, emphasised how cloud companies have a strong appeal to investors because *«we are talking of a sector which is growing quickly»*. *«The entire economy is now digitalised»*, noted Diego Ciulli, Italian Policy and Government Relations, Google International, who, in providing an overview of the development of cloud computing to the present day, defined the cloud as something which *«in reality had already been thought of in the previous millennium, but became real much later, first in America and then more slowly in Europe»*.


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Innovating with research

Innovation is the result of investment in infrastructure by a country that believes in research. So says Alessandro Ovi, Publisher and Editor, MIT Technology Review, and Director, STM, who focussed on some of the sectors in which technology will record the greatest growth: applied technologies, energy (fundamental, considering that *«the use of alternative sources, or improvement in their use, will be at the heart of research over coming years, given that fossil fuels are running out»*), communication and connective technologies, which Ovi defines as *«the global communication connection»*, or *«one of the greatest results of real poverty eradication and a contribution to the development of countries, since it brings connectivity worldwide»*.

Managing research

At the next roundtable the discussion focussed on how technologies can improve our lives by applying research. For Pedro Alberto Gomez Rodriguez, Global Innovation Leader, PwC Spain, innovation comes above all from the right mix of creativity (in other words curiosity, observation, questioning, associating and experimenting) and discipline (policies, processes, products, people, partners), and speed is the element which unites them. A success story was also told by Aldo Uva, Chief Operating Supply Officer of Ferrero International. As well as having created *«a bridge between the past and the future in a very innovative way»* and having united "passion and people" Ferrero continuously invests to strengthen the link between product and science, which is essential in order to innovate.

Innovating with services

For anyone who knows how to leverage it, technology can be a strong efficiency driver. The companies wishing to make progress in the new globalised context must be able to confront numerous and important challenges, and the CFOs in this case have an even more fundamental role. *«We are in an era in which not only numerous changes are taking place, but they are also happening very rapidly,»* pointed out Carlo Alberto Carnevale Maffè of the Bocconi University of Milan, then focussing on how technology can optimise the company's internal processes. According to Marco Vulpani, Deloitte Financial Advisory Innovation Leader, it is necessary to pay attention to how the role of customers has changed. The advent of social networks and e-commerce have changed the methods of interaction and generated a constant flow of information. According to Vulpani *«innovation is not an opportunity, now innovation is the new baseline, if you don't innovate you don't survive»*. But what is innovation? *«It's a fresh idea that creates value, but not only that: just think about the role of incubators»*.

__15.__ Pedro Alberto Gómez Rodriguez, Global Innovation Leader PwC; __16.__ Aldo Uva, Chief Operating Supply Officer Ferrero International; __17.__ Panel Leveraging Technology for Efficiency; __18.__ Congress Attendees; __19.__ Panel Innovative Business Intelligence; __20.__ Gala Dinner at Palazzo Parigi; __21.__ Fausto Cosi proclaimed Chairman IAFEI

Innovating with business intelligence

During this panel, the discussion focussed on how to bring technological innovation to finance offices, and how to improve the performance of this business. A lot of pressure comes from the need to shorten and speed up the processing and presentation of data. «Processes are moving towards automation,» said Manuel Vellutini, Deputy CEO Business Strategy and Growth Tagetik Italia, *«which means reducing the risk of presenting incorrect data to investors, having a more complete vision and developing a more targeted structure as well as connecting operational information and financial information»*. The speech by Sergio Colella focussed on the new role of the CFO and presented the results of a survey which involved 300 CFOs, from which it emerged that the priority is that of creating solid risk management which can prevent the problems arising from security. Digitalisation ranks second, followed by the increasingly business-oriented approach of the CFO.

Innovation parameters. An industry to be "re-invented"

The CFO Summit, on its second day of works, then focussed on the issues of a company's ability to reinvent itself and on the opportunities or variables that influence its economic success. Gerhard Dambach, CEO Southern Europe Bosch Group and CEO Italy Robert Bosch S.p.A., spoke of how change and volatility are the levers of the market: *«if you have a smart idea, you can conquer the market»* he stated. Efficiency and flexibility are the drivers of change.

The emerging models of global companies

Donato Iacovone, Managing Partner of MED EY, underlined the importance of Big Data and Data Analytics: with Internet connections, we can constantly receive and release information. The data is almost infinite. Everything is connected in a company and generates information. The biggest mistake that a CFO can make is to think that Big data and everything that rotates around it are the responsibility of the IT department: *«Big data is a tremendous resource that must be used in all its aspects. CFOs must understand its importance and lead this revolution within the company, giving it the appropriate weight»*.








***22.** Gerhard Dambach, CEO Southern Europe Bosch Group and CEO Italy Robert Bosch; **23.** Armand Angeli, IAFEI Organizing Committee and Area President EMEA ; **24.** Donato Iacovone, Managing Partner Med EY; **25.** Valerio Nannini, Senior VP and Head of Strategy and Performance Nestlè; **26.** Sergio Lamonica, IAFEI Organizing Committee; **27.** Riccardo Barbieri Hermitte, Chief Economist Ministry of Economics and Finance of Italy; **28.** Gregorio De Felice, Head of Research and Chief Economist Intesa Sanpaolo; **29.** Platon Monokroussos, Deputy General Manager and Group Chief Economist Eurobank Ergasias; **30.** Panel Capital Markets and Crossborder Investments*

According to Valerio Nannini, Senior VP, Head of Strategy and Performance Nestlè, growth is becoming the lifeblood of the global economy and the strategic priority of CEOs and CFOs. On financial markets companies are increasing their value thanks to innovation, but to achieve innovation the main element must be passion. Entrepreneurship and innovation must become a single being.

Tax policy and debt sustainability

How sustainable is the debt? How much can be paid back? Not only public debt, but also household and business debt. Currencies and interest rates are positively influencing the GDP of key countries in the euro zone and peripheral countries, but the sustainability of sovereign debt is linked to stronger growth prospects, greater flexibility in the growth and stability plan, and the need for investment in innovations that can support the creation of jobs and greater productivity. These issues were discussed by the panel moderated by Sergio Lamonica, IAFEI Organizing Committee, featuring Riccardo Barbieri Hermitte, chief economist at the Ministry of Finance and Economy, the chief economist of the Intesa Sanpaolo Group Gregorio de Felice and Platon Monokroussos, Deputy General Manager and Group Chief Economist Eurobank Ergasias Greece.

Riccardo Barbieri Hermitte, speaking from Italy, stated that *«the Government is aiming to lift real GDP growth above 1.6%" which is forecast for 2016 and to reduce the debt to GDP ratio. Italy's credibility is growing thanks to the fiscal discipline which we have demonstrated, by controlling spending»*. Also Gregorio De Felice was optimistic and, in his view, the outlook for the Italian economy is favourable and the country's GDP will grow by more than 1% in 2016-2017. *«However,»* the economist added *«growth will be lower than the 1.6% forecast by the Government and will stand at around 1.2 and 1.4% respectively for 2016 and 2017»*. Monokroussos spoke of Greece in positive terms, illustrating

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how the programme of internal devaluation and fiscal austerity have facilitated the elimination of the pre-crisis imbalances and how there is also a significant improvement in the national regulatory context.

Competition and regulatory barriers

Competition is the best incubator for technologies and innovation. Free trade and the absence of barriers influence a country's competitiveness or indeed entire sectors of its economy. The recurring international episodes of financial instability entail the risk of protectionism and anti-competitive responses. A tough policy of international coordination is necessary.

Salvatore Rebecchini, member of the Italian Competition and Markets Committee, in going over the history of economic development and citing the example of China, underlined that the system of state regulation must be revised: *«a country's ideas must be listened to and the market must drive companies into a process of continuous evolution. The positive relationship between competition and growth has been amply demonstrated by economic literature: to increase productivity it is necessary to increase competition, to increase competitiveness it is necessary to have a system of effective but not oppressive regulation and, finally, what is very important for growth is the link between competition law and the result in terms of growth.»*

Capital market and foreign investment

Raffaele Jerusalmi, CEO of Borsa Italiana, and therefore the "host", set out the numbers of Borsa Italiana and of the London Stock Exchange, underlining that it is a particularly positive moment for IPOs. Jerusalmi then presented the success of the Elite programme, a platform to facilitate the encounter of businesses and the community of investors (private equity, venture capital, etc.) and to create networking and coaching. Again from Italy was the banker Roberto Nicastro who spoke about how in recent years the governance of Italian companies has greatly improved. This is because, according to Nicastro, many innovations have been introduced, not limited to technology, but also in governance itself, citing the example of the new company boards which now have a significant female presence of around 40%.

It was then the turn of Navid Chamdia, number one at Real Estate Investments of the Qatar Investment Authority, who recalled that Italy accounts for 4.5% of the investments in Europe made by the sovereign fund of Qatar Investment and that this share is destined to rise. *«We believe strongly in Italy,»* Chamdia said. *«A recurring issue for investments by sovereign funds is looking for stable income or an appreciation in the capital invested and with the growth of the economy income rises; Italy is attractive for this very reason. In addition, also the country's human resources are interesting, above all in the financial sector»*. Finally, Eugenio Sidoli, Chairman and CEO of Philip Morris Italia, spoke about innovation and noted the case from his own sector, underlining how in a market which acts on the basis of "damage limitation", there is constant research focussed on finding solutions to make cigarettes increasingly less harmful.

Innovating cash management

First "technical" discussion panel regarding the changes made to cash management. The roundtable was coordinated by the IAFEI ITC Chairman Omar T. Cruz and involved Dominique Chesneau, ITC member, Gianfranco Amoroso, Director Finance, SNAM Group and Richard Chenga-Reddy, Head of Regulatory Affairs Standard, Chartered Bank.

Chesneau explained how the shadow banking system and financial technology companies (Fintech) are now the two sides of the new financial world. Gianfranco Amoroso instead briefly set out the history of Snam which, after the separation from Eni, started a major process of change in its management. There was an optimisation process in the period 2013-2014, through new use of the public and private debt capital market, banking incentives and institutional lending. Richard Chenga-Reddy, on the other hand, focussed more on the impact of technologies and innovation on the banking sector thanks to which banks have introduced various technological innovations (Internet banking, mobile banking, etc.), but have not changed in terms of their substance. Hence the need for greater regulation and the use of technology to support the change.

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Operating control

The IAFEI ITC Chairman Frédéric Doche presented the results of the fifth research study undertaken by the Permanent Observatory on operating control systems, moderating a roundtable consisting of the finance managers Cécile Falchier (Sage), Stefano Grassi (Luxottica Group) and Jimmy Ysmael (Ayala Land). According to the Observatory, currently 3 companies out of 4, in other words 75% of those interviewed, use benchmarking, while an almost equal percentage, 72%, of controllers working in large companies believe that Big Data is important for their work. In addition to this, now near one third of companies publish reports within 5 days of closing them: 31% of companies do so, clearly up compared to 12% in 2014. *«These are interesting figures, and they show how the new competitive context always presents fresh challenges for CFOs, and how this creates the need for new tools which can offer increasingly dynamic data analyses in real time,»* argued Cécile Falchier. Stefano Grassi, on the other hand, emphasised the difference between producing and analysing data, underlining how a lot time is spent producing data but little analysing it, when detailed analysis could help better understand the market. Just as operating control that could really "link numbers and processes" would be more effective. Jimmy Ysmael also dwelt on the importance of analysis and underlined how also in the real estate sector financial data analysis systems help the work of CFOs.

Ethics in the global market

A transparent vision and a mission inspired by ethical values can lead to exceptional investment returns. This issue was addressed by Luis F. Ortiz, Chairman of the IAFEI International Committee on Ethics, Brunello Cucinelli (founder and CEO of Brunello Cucinelli), Tomaso Cenci (Partner Gianni, Origoni Grippo&Partners), and Katya Lusova (Associate Member Services and Advocacy TRACE International). Cucinelli's comments were based around his own personal experience: *«I have always sought to work for the dignity of man because work increases the dignity of man,»* the entrepreneur said, then emphasising that this is a "magnificent" moment for humanity thanks to the Internet. *«Voltaire said that if you do not want to accept the changes of your time you will be left with the worst of them. We must get back to planning again,»* said Cucinelli who then ended by saying that the future lies in returning to a union of spirit and mind, because humanity cannot be guided just by

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***31.** Lunch; **32.** Navid Chamdia, Head of Real Estate Investments Qatar Investment Authority; **33.** Roundtable Management Controllership Innovation; **34.** Omar T. Cruz, Presidente IAFEI ITC; **35.** Gianfranco Amoroso, Finance Director SNAM Group; **36.** Richard Chenga-Reddy, Head of Regulatory Affairs Standard Chartered Bank; **37.** Dominique Chesneau, IAFEI ITC Member; **38.** Luis F. Ortiz, IAFEI ITC Chairman; **39.** Tomaso Cenci, Partner Gianni, Origoni, Grippo & Partners; **40.** Brunello Cucinelli, Chairman and CEO Brunello Cucinelli; **41.** Katya Lysova, Associate Member Services and Advocacy TRACE International*

numbers. Katya Lysova focussed on combatting corruption. *«It is the poorest who usually bear the weight of corruption,»* she stated, *«and yet paying bribes does not bring any economic benefits nor does it ensure security in the workplace, but rather we risk entering a vicious circle in which the counterpart keeps on asking for more»*. Tomaso Cenci then recalled how fighting corruption is not important just for lawmakers, but for everybody. Italy is working to improve its anti-corruption law and doing so quite quickly.

Global fiscal prospects

The continual changes in the national taxation systems and their increasing harmonisation will have a significant impact on the work of CFOs. This was discussed by Piergiorgio Valente (IAFEI ICT Chairman), Valente's colleague Jérome Bogaert, Head of Tax and Legal Services in PwC, Fabrizio Acerbis and Deloitte Partner Henk Koller. Focussing on the importance of the BEPS, Jérome Bogaert emphasised how the shared goals of the BEPS and the taxation system must be those of regaining public trust in the national and international taxation system, guaranteeing greater certainty for companies and creating greater consistency in a country's tax policies with those of others, also improving the guarantees for taxpayers and investors. Henk Koller spoke about the important role of tax consultants, highlighting how each country has its own perception of this role: in France, for example, tax consultancy is the domain of lawyers, while in other countries accountants hold sway. So what does a tax consultant do? It depends on the country we are talking about, because it is a role that changes depending on the area it works in and depending on the technology, it can draw on. Finally, also Fabrizio Acerbis spoke about changes and stressed how the ways in which tax administrations are interlinked are changing because the exchange of information has multiplied. *«Companies must be aware,»* he said *«that transparency and divulgation are*

__42.__ Roundtable Global Taxation in Perspective; __43.__ Roundtable IFRS Developments; __44.__ Sergio Lamonica named ANDAF Honorary Member; __45.__ ANDAF Board

increasingly becoming the environment in which we need to work, there is no alternative and I think that this is a trend which is already on-going and will not change».

Developments in the IFRS

How do the IFRS meet the expectations of investors and of the financial community? This was discussed by the Chairman of the IAFEI Advisory Council Conchita Manabat, Vincent De La Bachelerie (Partner EY), Amaro Luiz de Oliveira Gomes (IASB Board Member) and Orazio Vagnotti (Partner KPMG). Vincent De La Bachelerie raised several questions: how to best represent financial performance? What information is relevant and what is not in drawing up these standards? *«The challenge is to keep responding to the needs of investors,»* concluded De La Bachelerie. For Gomes, the changes that have been taking place in recent years will influence the world of business and future finance and, therefore, also its standards. In this regard, Gomes noted that many people have accused the IASB of taking an interest in studying financial instruments only after the economic crisis of 2008, but Gomes refuted this. With the crisis there was simply an increase in the need on the part of financial administrators to have more detailed data and guidelines. This has led to the creation of new standards and an improvement in research studies and the classification of financial instruments. *«The IFRS were introduced in 2005, 10 years have gone by. What impact have the IFRS had over this time?»* Orazio Vagnotti started his contribution by raising this question. For the Partner from KPMG the results are certainly positive: company interaction has increased and improved, countries have adopted the same standards and this has facilitated M&A work, transparency, investments and commercial transactions.

See you in Moscow (with Fausto Cosi as Chairman)

The meeting in Milan was also the moment to appoint the new IAFEI Chairman for 2016. Fausto Cosi, the current Chairman of ANDAF, was the person chosen to succeed the Mexican Luis Ortiz-Hidalgo. The handover was formalised at the end of the two days of meetings in Milan at the Russian pavilion at Expo since Russia will host the 46th IAFEI international conference in 2016.

So thanks to Ortiz-Hidalgo for the great work he has done and all best wishes to Fausto Cosi in his new role. See you in Moscow.

Argentina, Article: The Chance for Argentina

By **Carl Moses**, Frankfurter Allgemeine Zeitung, November 16, 2015,Frankfurt am Main, Germany.

The election of the liberal-conservative Mauricio Macri as new president can already now be termed as a historic event in many regards. - perhaps even for entire Latin America. For the first time a democratically elected president will govern in Argentina who is not coming from one of the two large traditional parties - the peronist party PJ, or the social democratic UCR. The party, only ten years ago established by Macri as an answer to the repeated failure of the old parties, is the first governing party, which is not peronistic, but at the same time also not anti-peronistic. Macri has the ability, to finally unite the Argentinians, and not to divide them.

Macri´s party PRO is as well the first governing party in Argentina since hundred years, which is committed to a market economy, without reservations. This still does not mean, that suddenly the majority of the Argentinians is in favor of liberal economic thought. To the contrary: Polls do show, that a large majority of Argentinians, by comparison to other countries, oes show great skepticism towards the market and wishes a strong intervention by the state in the economy. The election victory of Macri should therefore not be misunderstood as a departure by the population from the economic policy of the departing president Christina Kirchner.

The Kirchner era, which began 2003 with the husband of Kirchner and predecessor Nestor, is viewed by most Argentinians as an era of economic upturn and social achievements. In the first eight years of their government terms, the Kirchners, in the shadow wind of the raw material boom, and not least because of their hard stand against foreign creditors, could spend the money voluminously and distribute social entitlements. Also in the last eight years of economic stagnation, with at the same time galloping inflation, and ever scarcer becoming foreign currency reserves, the government managed, to administer the scarcity in such a way, that most of the Argentinians were not impacted by it. Macri won the election especially, because the majority of the Argentinians was simply hung up with the authoritarian government style and the friend-enemy-thinking of the Kirchnerism, which was permanently looking for conflicts.

Whether Macri will be successful, will depend, on whether he will be fortunate with his economic policy. There, Macri is standing before immense and immediate challenges, of which many Argentinians are not fully knowledgable. The foreign reserve cash box of the central bank is empty, the Peso is clearly overvalued. ‘The quickly increasing government deficit is financed by the printing press, because Argentina, because of its never ending debt conflicts, has hardly access to foreign credits.

As large as the challenges are, though, the chances for Macri are, to end the decades of Argentina tumbling from boom to crisis and to bring it back onto a stable path. As Macri rightly states, Argentina is not short of foreign exchange but short of trust. According to estimates, the Argentinians hold abroad foreign currencies in the countervalue of half an annual GDP in bank safes or have them bunkered below mattresses.

The foreign investments are significantly bigger than the foreign debt. In addition, the farmers of Argentina are hoarding soy beans by the value of billions, because they are waiting for a lowering of the crazy export taxes and for a fair exchange rate for their foreign currencies from exports.

The new president is a proponent of the market, his voters are more skeptical

As well, Macri must start negotiations quickly about a settling of the debt conflicts resulting from the state bankruptcy of 2001, in order to regain access to foreign capital. In order to create trust at home and abroad, it is necessary, to restructure the discredited statistical office, in order to have citizens and investors believe again in official data of inflation, production and social development. The long due devaluation of the Peso should take place rather quickly, so that investors can plan with realistic currency relationships.

A view to the neighboring countries shows, that a devaluation without a concomitant high inflation is possible. Still, for this the Argentinian central bank has to give up its policy of negative real interest rates, and it must strive in the future for a credible inflation target. The recession, which will be hardly avoided in future, must be socially featherbedded, in order that Macri will not lose his political capital.

Macri is the first president since thirty years, who will not have a majority in parliament. But as a compensation, with Pro there will be for the first time the same party in power in the nation and in the strategically important city and province of Buenos Aires, and with this it will reign over all important budgets of the country. This financial lever, and his great talent for consensus building, should enable Macri, to create the necessary political basis for his initiatives. Should Macri be successful in Argentina, he could move up to the leader of a liberal counter movement against the spreading out leftist populism in South America.

To be noted: On December 17, Argentina lifted the restrictions on the trading of the Argentinian Peso, a step which had been expected since months. Shortly after beginning of free trade, the Peso devalued by 44 percent. And moved back to minus 32 percent by December 22, 2015

from Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany, November 26, 2015. Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

Asia, Article: Asia 2016 Forecasts: Managing Downside Risks

By **Mark Canlas**, head of Sovereign and Industry Team in the bank's Risk Management Unit, BDO Unibank, The Philippines

By now, forecasts for 2016 and 2017 are out. But, before we celebrate a substantive acceleration in Asia's projected growth (excluding China), what did we fail to see in the two years and how do we impute these failures to improve our management of downside risks?

Using the International Monetary Fund's (IMF) World Economic Outlook released in October 2013, forecast for 2014 was more or less accurate providing optimism for October 2015 projections for 2016. The largest unpredicted downside in Asia was Japan, which was forecasted to grow by 0.9% but registered a 0.1% contraction. China and ASEAN 5's actual performance was close to forecasts.

However, the forecast for 2015 made two years prior was significantly lower than forecasted 3.8% global Gross Domestic Product (GDP) growth at 3.1%. Aside from larger cuts in forecasts for advanced economies, China (7.1% to 6.8%) and Japan (0.8% to 0.6%) suffer substantive moderation.

	Oct 2013 Forecasts		Oct 2015 Actuals & Trend		
Real GDP Growth	2014	2015	2014	2015	2016
World	3.3	3.8	3.4	3.1	3.6
..Japan	0.9	0.8	-0.1	0.6	1.0
..Emerging & Developing Asia	6.5	6.5	6.8	6.5	6.4
....China	7.4	7.1	7.3	6.8	6.3
....India	5.6	6.4	7.3	7.3	7.5
....ASEAN 5	4.7	5.4	4.6	4.6	4.9

The IMF rightfully noted "the growth slowdown in China is so far in line with forecasts, its cross-border repercussions appear greater than previously envisaged." This is the downside risk that Asian policymakers and businesses need to contend with and manage in the next two years. Econometric models are built on the foundations of the past but used to predict the future. In doing so, it implicitly assumes that past relationships between variables like commodity prices, inventory stocks and derived demand growth from forecasted remain the same. It seems that the tenuous dynamics of these variables and their second-round effects on growth moved in the same direction but perhaps in a larger magnitude than expected.

IMF concluded that "raising both actual and potential output through a combination of demand support and structural reforms continues to be the economic policy priority". However, the current policy environment provides diminishing returns to demand support as monetary and fiscal policy have been significantly loosened following the 2009 global financial crisis. Most if not all economies have close to zero interest rates and deficit financing is expected to become more costly as the Fed is expected to begin its policy tightening.

In China, part of its structural reforms is political as it tackles extravagance and graft in the ruling party. It is of great importance that former security czar, Mr. Zhou Yongkang, has been sentenced to life imprisonment signaling that the leadership will prosecute even its most senior members. It might cause some internal tensions as more investigations come. But, it is a step in the right direction and is widely expected to remain manageable. The Chinese government targets 6.5% as the growth floor 2016-20 and will support it using fiscal and monetary expansion in the near term but interest rates are expected to move up to stem sudden surges in corporate debt. The Economist sees that 2016-17 growth will be above the government target but forecasts growth to slow gradually to 4.7% in 2020, implying a 5.6% growth which is below the government floor. It placed a 30% chance of hard landing (defined as -1.5 percentage points below 5.6% forecast) on the basis of real estate oversupply causing a correction. Another downside risk in China is its exchange rate could slow exports growth as the US Dollar (USD) to which the Chinese Yuan (CNY) is somehow pegged appreciates.

Japan, the Asia's second largest economy, was one of last year's biggest underperformers in terms of forecasts against targets. It has done a lot in terms of demand support (Mr. Shinzo Abe's first two arrows of growth) – more QE in Oct, tax cut to below 30% over the next few years and signing into TPP in October. Its hosting of World Cup 2019 and Olympics 2020 should further strengthen its income from tourism as incoming tourists increased by 30% in 2014. However, it has yet to fully deliver on structural reforms due to political costs. It is notable that significant gains have been done to on agriculture, corporate governance and VAT reform to allow a reduction in corporate tax rates. Some promises are lagging behind like labor market reform particularly increasing female participation in the workforce and, and further liberalization of its energy market given that it has the world's most expensive energy. The downside risk is Mr. Abe's political support might be declining after pushing for broader defense powers. Mr. Abe's third arrow is estimated to cost 2 percentage points of GDP growth in the next ten years if left undelivered.

Closer to home, ASEAN 10 is estimated to be $2.5 trillion in combined GDP accounting for 3.4% of global GDP. With a cumulative annual growth rate (CAGR) of 8% 2015-20, the region is expected to account for 3.7% of global GDP and three-quarters of Japanese GDP by 2020. By 2020, it will be home to close to 700 million people thus ASEAN integration is one of the most monitored changes of 2015. By the end of 2015, ASEAN marked its transformation into the ASEAN Economic Community. What does this mean?

Essentially, this marks the end date for most tariff rates to fall to zero, for trade facilitation work and closer coordination of economic policies that is envisioned to bring the region to something similar to the European Union or the North American Free Trade Area. As the Asian Development Bank's regional expert, Mr. Iwan Azis noted, the vision is coming soon and is moving quickly. Given national restrictions and sensitivity of individual economies, full opening up and integration of the services sector and full production base integration may happen at a slower pace.

As before, the pace and breadth of integration is expected to be appropriately driven by the private sector rather than governments. National ownership restrictions on banking, utilities and other services will be steadily loosened as political barriers to reform fall.

The arising risk seems not to the global economy as ASEAN integration allows all firms to benefit from lower cost of goods and faster turnaround within the ASEAN production chain. The companies in the region will be faced with varying degrees of challenges as integration deepens. Each economies' big players will have to defend their market shares against new entrants. Talent will be harder to retain as new companies enter the fast growing region. Mergers, acquisitions and foreign direct investment will change business landscapes. But, interestingly most trend spotters see relationships and local knowledge to become more important. All-in-all, it will be great for consumers as competition provides goods and services at cheaper prices and better quality. It will be a double-edged sword for corporations as opportunities of expansion also requires them to defend existing market share.

Mark Canlas leads BDO Unibank's Sovereign and Industry Team in the bank's Risk Management Unit. He previously worked as the economist of the British Embassy in charge of Southeast Asia fiscal and monetary policy analysis and was consultant and researcher for the International Labor Organization, United Nations University and University of the Philippines School of Economics (UPSE). He took his undergraduate economics degree from UPSE and masters of commerce (finance) from the University of Sydney on an ADB-Japan scholarship. He also took postgraduate courses from the London School of Economics and the University of London.

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CHINA'S "NEW NORMAL": OPPORTUNITIES IN A SLOW-GROWTH ECONOMY.

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EXECUTIVE SUMMARY

Headlines about China have grown increasingly pessimistic as the country experiences its weakest economic growth in many years. China-driven worries have recently fueled a renewed slump in commodity prices and an emerging markets sell-off, adding to long-held concerns that the country could experience a "Lehman moment" after a rapid rise in debt since the 2008 global financial crisis. While T. Rowe Price investment professionals do not think China is on the brink of a full-blown crisis, we believe that China's large debt level will weigh on its growth for many years. This slow grind scenario raises the likelihood that China is in for a long period of below-potential growth similar to Japan's lost decades starting in the early 1990s. Despite this bearish backdrop, we continue to see opportunities in select Chinese companies, many of which are adapting to slower topline growth.

WHAT IS CHINA'S "NEW NORMAL," AND WHY IS IT HAPPENING NOW?

In May 2014, Chinese President Xi Jinping announced that China was in a "new normal" of slower economic growth. The new normal comes as China's economy is shifting to new growth drivers and away from the old growth model that relied on manufacturing and investment. While the old growth drivers worked remarkably well for the past three decades, in recent years, China's GDP growth has slowed even as investment has increased. Because the old investment-driven model is producing diminishing returns, China's growth model had to change.

Manufacturing has long been China's growth engine, but the services sector is gradually taking its place. Moving away from a manufacturing-driven economy to one led by services and consumption is a long process that will take many years. This transition will entail a lower growth rate than the double-digit GDP expansion rates of previous decades.

A SPECTACULAR RISE IN DEBT

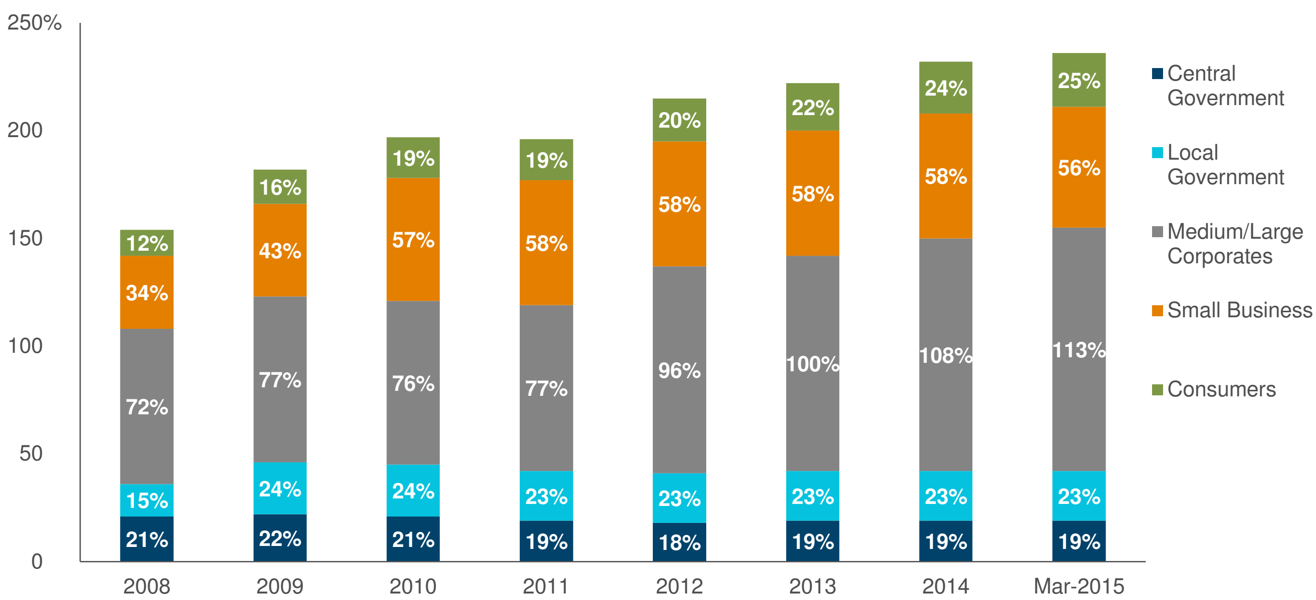
A big factor driving China's changing economy is that its old model was funded by debt—an unsustainable growth driver over the long run. China's debt level climbed rapidly following the 2008 global financial crisis after it announced a huge economic stimulus package.

Including corporate, household, small business, and government debt, China's indebtedness rose from about 150% of GDP in 2008 to roughly 240% of GDP in 2015—a spectacular increase by any global historical comparison. Such a rapid rise in debt has often led to a financial crisis, not only in emerging markets, but also in developed ones.

Much of the debt increase lies with medium-sized to large corporates, as shown below. This category includes many state-owned enterprises (SOEs)—typically, local government entities set up to fund infrastructure projects. Over time, however, many of these SOEs became "zombie" companies—unable to pay off their debt, yet kept alive by various local government subsidies.

Figure 1: **Where Is the Debt?**

As of 31 March 2015



Levels of debt rose rapidly after 2008, but the pace of increase has slowed.
Much of the corporate debt in China is at the SOEs and may be considered quasi-government.

Source: Morgan Stanley.

Uncertainty about the extent of nonperforming assets in China's banking system is a big concern. Our regular visits to China have found that smaller lenders in the inner provinces define nonperforming assets differently from a big bank in Beijing. Because of the varying ways that nonperforming loans (NPLs) are accounted for around the country, we believe that the level of NPLs in China's financial system is much higher than 1.5%, the latest figure provided by the central bank.

In fact, we suspect that much of China's credit growth in recent years has been driven by banks giving additional loans to troubled borrowers to allow them to pay off their existing debt. This "ever-greening" of existing debt is troubling, since it helped contribute to Japan's financial crisis in the 1990s.

NO LEHMAN MOMENT, FOR NOW

In contrast to the most bearish forecasts, we don't think that China is at risk of an imminent large-scale financial crisis. China has one of the biggest current account surpluses of any country on an absolute basis and is the world's biggest holder of foreign exchange reserves (roughly US$3.5 trillion as of the end of September). Both provide the country with ample resources to support its financial system.

As long as China's government can finance its banking system by maintaining some control over the capital account using liquidity from the current account surplus and has central bank reserves at its disposal, we believe it can avoid a crisis by kicking the can down the road—just as the European Central Bank did at the height of the euro sovereign debt crisis.

Unlike U.S. bank regulators who allowed Lehman Brothers to fail, policymakers in China are opposed to letting financial firms go under, since doing so would be too destabilizing. Similarly, cleaning up the NPLs in China's banks could produce negative GDP growth—an unattractive option for Chinese policymakers.

A LONG, SLOW GRIND AHEAD

Rather than a Western-style banking crisis, we think the most likely outcome is that China will see years of steadily slowing growth as it avoids the pain of deleveraging and sticks with its current "kicking the can" strategy. At the central government level, China still has low debt and deficit levels, giving policymakers the flexibility to support other over-indebted sectors.

Maintaining the status quo will allow China to forestall a Lehman-type crisis and avoid a painful deleveraging process. However, this is not a cost-free strategy in the long run. Misallocated capital, overcapacity in certain industries, and investment in projects with diminishing returns will continue to weigh on China's economy, resulting in GDP growth slowly grinding lower over time.

China continues to reform its economy, and the changes in some areas are encouraging. However, reforming the SOEs that make up a large part of China's economy is a long and complex undertaking that faces stiff resistance from competing interests. Whether or not these reforms will be successful is still uncertain.

Given China's ability to service its debt, unwillingness to let financial firms go under, and emphasis on stability, we believe that China could be in for a "lost decade" of below-potential growth, much like what Japan endured after its property market bubble burst in 1991.

WHERE DO WE SEE OPPORTUNITIES IN CHINA'S CHANGING ECONOMY?

We are finding pockets of opportunity in businesses that are taking share in their respective markets despite China's slowing economy. Technology companies, particularly some Internet names, and select consumer and services companies are still growing. Most of our research centers on private sector companies, where people are proving more adept at responding to the new environment.

In the consumer area, we're focusing on innovative businesses that are introducing new and different products, as Chinese consumers become more sophisticated in their preferences. In the services area, we think that health care and logistics are promising areas. The opportunity set in services is currently small but has a lot of room for growth.

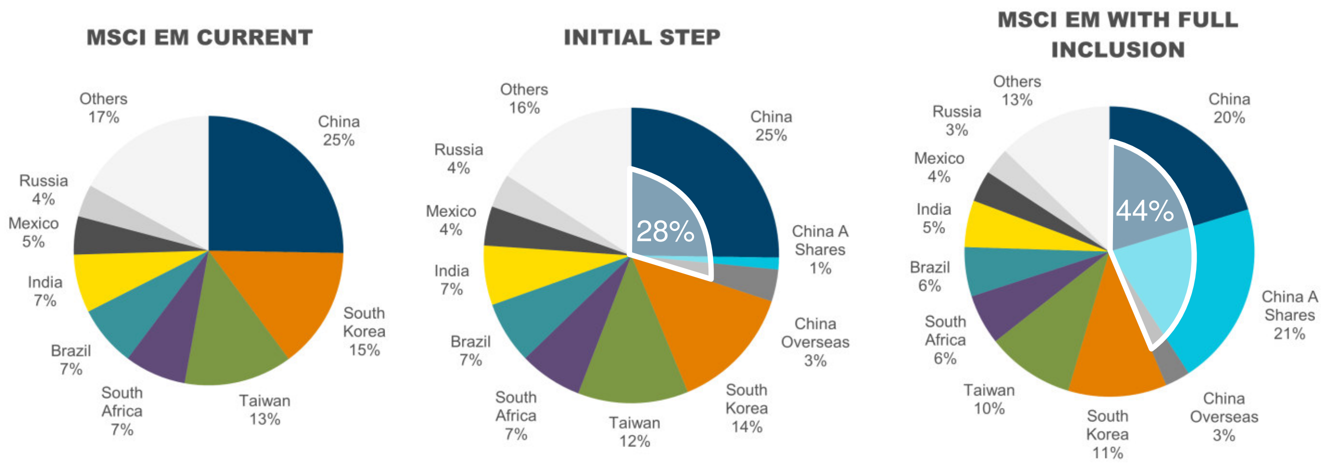
We try to seek out businesses that are adjusting to lower—even negative—topline growth. Many companies realize that the strong demand and cheap money of recent years is gone for good and have restructured their businesses to adapt to a tougher operating environment.

Longer term, we think that China's A share market will open up many opportunities. Right now, the A share market comprises over 2,000 Chinese companies whose shares are accessible to overseas investors only through limited quota systems. China's government is slowly opening up the A share market, which we believe will be fertile ground for stock selection in the coming years.

Currently, China accounts for just 2.7% of the MSCI All Country World Index. After the eventual inclusion of the A share market, however, the country's allocation could more than double to 5.9%. Given China's relatively low exposure in global equity indices, we believe that demand for Chinese stocks will inevitably rise as MSCI increases the country's weighting over time.

Figure 2: China Will Become Larger Within Global Indices

As of 31 May 2015



China weight in AXJ[1]	29.9%	China weight in AXJ	35.0%	China weight in AXJ	49.4%
China weight in ACWI[2]	2.7%	China weight in ACWI	3.3%	China weight in ACWI	5.9%

[1]MSCI Asia-Ex Japan (AXJ)
[2]MSCI All Country World Index (ACWI)

Source: MSCI.

CONCLUSION: STOCK SELECTION IS KEY TO FINDING OPPORTUNITIES IN CHINA'S NEW NORMAL

After decades of double-digit GDP growth rates, China's economy is at a watershed. The old growth drivers of manufacturing and investment are losing their effectiveness, forcing the government to bolster services and consumption as new growth engines while it grapples with a ballooning level of debt. Though we think a Lehman-style crisis jeopardizing China's financial system is unlikely, maintaining the current policy of supporting troubled SOEs and avoiding the deleveraging process will be reflected in slowing growth in the coming years.

This bearish scenario, however, does not preclude us from finding good investment opportunities in China. Many companies in the consumption and services areas continue to show solid growth even as China's GDP growth grinds lower. We are focused on finding companies that are showing innovation, restructuring their businesses, or taking other actions to help themselves adjust to the new normal.

Finally, we would note that several Japanese companies generated considerable value for shareholders even during the country's decades-long bear market. We believe that similar opportunities exist in China and that T. Rowe Price's research capabilities and careful stock selection will allow us to find these businesses despite weaker economic growth in years ahead.

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China, Article: The Yuan Establishes Itself at the Expense of the Euro

The International Monetary Fund IMF recognises the Yuan as a reserve currency. This may strengthen the role of the Chinese currency in the market.

By **Gerald Braunberger**, Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany.

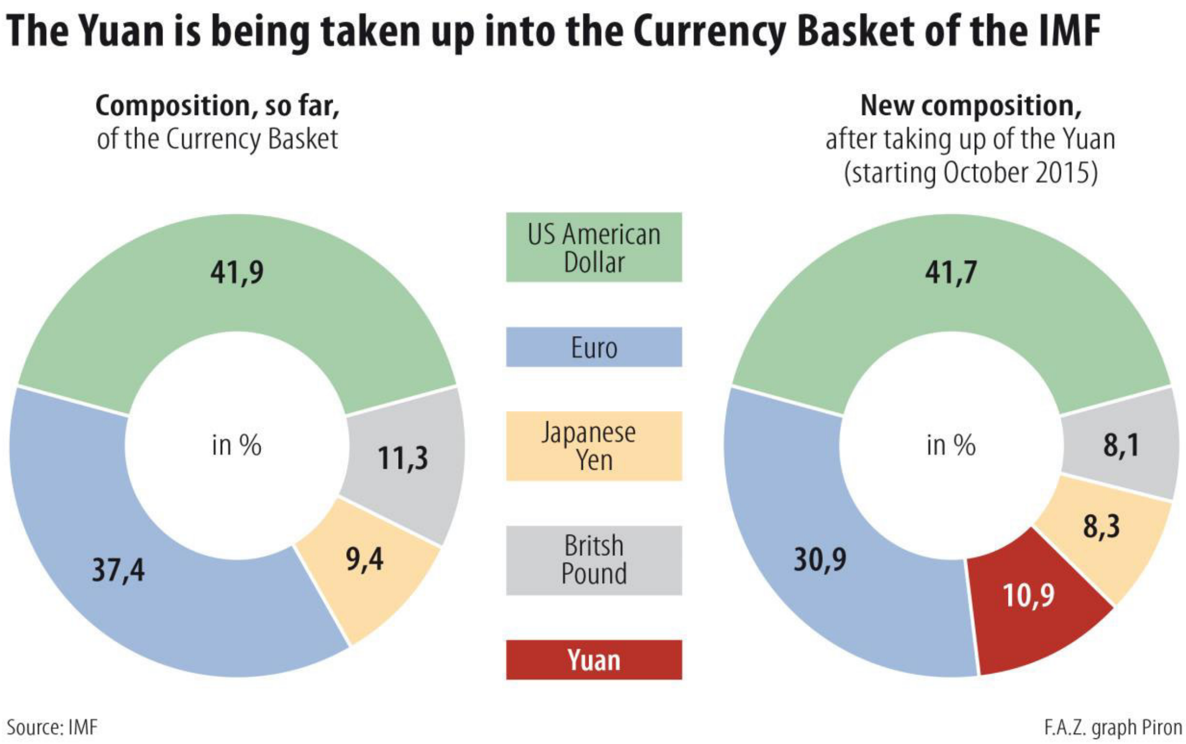
Gb. Frankfurt, December 1, 2015. Asia proceeds at the expense of Europe. Whereas especially the significance of the Chinese Yuan (Renmimbi) is increasing, the leading European currencies have to fight for their weight in the world. The latest example does deliver the International Monetary Fund IMF. Its decision of yesterday Monday, to recognise the Yuan as the fifth reserve currency, did not come unexpectedly. With this and starting October the Yuan will become member of a currency basket, from which the IMF computes the value of its artificial money (special drawing rights).

As well, the weight of the Yuan in the currency basket of 10, 92 percent, did not surprise, but did the clarity, with which the two European currencies did loose ground. The weight of the Euro was reduced from37,4 to 30,9 percent, and the one of the Pound from 11.3 to 8,1 percent. Even when so far the weight of the Euro had been significantly above its importance in the foreign currency trade and in international securities trades, the decrease will be observed in the markets with attention, is said in a commentary by the big American bank Bank of New York Mellon.

A decreasing attractiveness of the Euro can be recognised since quite some time in the context of the foreign currency reserves as held by central banks, finance ministries, and special government funds.

Not all countries, among which also China, do report the composition of their foreign currency reserves, but the IMF does publish quarterly a list of the known reserves and their breakdown. According to this, and as to the known foreign currency reserves of 6666 billion US Dollar, still 63,8 percent related to the US Dollar, 20,5 percent to the Euro, 4,7 percent to the Pound, and 3,8 percent to the Yen.

The Yuan, so far, played practically no role whatsoever, and also the weights of other currencies like the Australian and Canadian Dollars and the Swiss Franc are very small and can be disregarded. Important to note is, however, that the Euro, before the breakout of the Euro crisis, still had a weight of 27,7 percent.



With the recognition of the Yuan by the IMF as official reserve currency, the Chinese currency may be purchased as reserve currency also by other central banks. This demand may become the bigger, the more the liberalisation of capital flows will gain ground. As finishing point of the liberalisation process is seen the year 2020.

The analysts of BNY Mellon have made an example calculation: Assuming, that the Yuan until 2020 achieves a weight in the foreign currency reserves held, of 5 percent, , and assuming further, that the size of the total of foreign currency reserves held will remain essentially unchanged until then, then until 2020 Yuan as foreign currency reserves will be bought by the amount of 391 billion US Dollar. Together with this, a strong demand for Chinese government bonds will come along, because foreign currency reserves are mostly being held in the form of government bonds.

The Yuan will become one of the three most important currencies in the world, says the Deutsche Bank. With a strong demand for it, will also come along pressure for a revaluation of the Chinese currency. Positive for the importance of the Yuan will also be the U.S. American intention, to allow for the trading of the Chinese currency in the USA.

from Frankfurter Allgemeine Zeitung, Frankfurt am Main, Germany, December 2, 2015. Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

Germany, Article: China Experts from the City of Selb, Germany, Continue to Write Their Success Story

New Chances for German Mid-Sized Companies in the West of the People's Republic

By **Dr. Hanns-Peter Ohl**, Managing Director and CFO, Erich Netzsch & Co. Holding KG, Selb, Germany; Article provided by GEFIU, Association of Chief Financial Officers Germany

As manufacturer of special machines, the Erich Netzsch GmbH is represented all over the world. With more than 20 years of experience in China business, the medium-sized corporation group, with group sales 2015 of 478 million €uro, belongs to the first users of market-specific financing solutions. Now, the group continues its success story.

With its 140-years history, Netzsch is a classical medium-sized family-owned corporation group. As manufacturer of machines, located at Selb, province of Oberfranken in Bavaria, Germany, we are producing thermoanalytical instruments for quality assurance, research and development, grinders and mixers for finest grinding of materials as well as pumps and systems for most varied tasks. The instruments and machines are used in almost all industries. Regionality and Globalization are no contradictions for us.

In spite of our close involvement in the province of Oberfranken in Bavaria, we are represented with production sales and service corporations all over the world. In total, the Netzsch Group employs more than 3,400 employees at 140 sites on all continents. Especially the business in China belongs to one of our most important cornerstones in the meantime. Today, we have three subsidiaries in China, two at Shanghai and one at Lanzhou in the West Chinese region.

First of all, the way into the intercontinental countries abroad is always a great step for a German medium-sized corporation. This is especially true for family-businesses. Our great success in China-business is even more remarkable. Presently, Netzsch continues to grow there: The factory at Shanghai is being enlarged and for Lanzhou the construction of a new production site, which will produce pumps for the markets of China and Southeast Asia as well as Australia, is being planned.

We are already producing ball mills and dissolvers – which are the most used machines for mixing solids to suspensions in industry – at Netzsch Shanghai and from there, we deliver them to customers in Asia, India, Australia/Oceania and Africa. In total, we will probably generate a third of our turnover in Asia and Oceania.

Key factors or our company have always been comprehensive practical knowledge and active closeness to our customers. Long-term trusted business-relationships with our customers as well as deep knowledge of the markets are related to this. Since turning to China, we have invested in developing knowledge and familiarizing ourselves with the particular country- and market-specific circumstances.

By means of constant exchange, knowledge of the market-particularities or of cash-management-matters, or as well of country-specific and cultural subjects was built up. Also thereby, we are well informed about the conditions, requirements and challenges in China in the meantime. This knowledge is integrated directly in our products and solutions for our customers.

We do not only rely on local solutions to generate a sustained value for the customer but also on the whole business execution. Since the end of 2011 at an early stage, we have used the possibilities of the RMB-Trade-Settlement-Scheme in international payments executions.

Since the middle of 2010, this allows cross-over transactions with Renminbi (RMB) and offers a range of advantages in the daily business: currency risks can be hedged directly in RMB. Naturally, this also reduces the costs for financial protection. We are also able to issue invoices in RMB by our German subsidiaries to enhance payment transactions and at least, to bundle them more effectively in the German headquarter. Further, international companies like ours are in a position to reach a bigger pool of potential partners among the Chinese corporations, so that the range of possible suppliers or customers is increasing.

Initially started as a pilot-project, the RMB-Trade-Settlement-Scheme was expanded to all Chinese provinces little by little. Since 2011, also RMB, acquired from Hongkong or other markets outside China, can be used for direct investments onshore. Due to that, the Yuandenominated part of the Chinese trading volume has grown from less of 2 % to up to roundabout 10 % already in 2013.

Due to this and to the continuous growth of the Chinese economy, new possibilities are also a result for us. The markets, in which we are active, are characterized by high attractiveness and they offer sufficient leeway for organic growth. In the active markets Netzsch wants to belong to the market leading corporations.

As part of our business philosophy we are further permanently asking ourselves how we can use the new possibilities. We are occupying new niches and we adapt our product portfolio as well as our processes to the local situations.

Concerning financing and payment-traffic, we also make use of external support. So far, the Chinese subsidiaries of Netzsch have worked for this together, especially with local banks. With HSBC the manufacturer of machinery is now in addition using an international service provider with excellent knowhow in China-business, who is also represented in other markets of the region.

So we are now discussing a cash-concentration-solution with which our processes for our internal financing will become more systematic and efficient. Because especially at globally acting corporation groups with subsidiaries in various countries, the internal group financing plays an increasingly central role regarding the to the point exact transfer of liquid financial means of money from one market to another one. Starting with a good information basis on a daily overview to all transactions, the treasury team can react quickly to possible bottlenecks in the payment traffic and, in the end, it can reduce costs.

Therefore, Netzsch is planning to install a master-account at the Shanghai-Free-Trade-Zone, in order to reliably transfer liquidity in this way as well as to provide it quickly to other units in the regions. Vice versa, a then possible need of liquidity in China can also be met with free cash flow from other group units in a more simple and less bureaucratic way. Whether this can be done manually or in automated fashion, on the same day or at larger time differences, we will still decide.

For the future we do estimate that new possibilities can be developed especially for German, medium-sized companies despite of lower growth rates. The latest turbulences are rather to be seen as a normalization than as business crisis signal.

According to our experience, especially the businesswise so far less developed western part of the country is offering further chances for foreign corporations and investors.

As already many international corporations have invested in the eastern and more developed provinces of China, business land there is rare and expensive. Also, investors are confronted with stronger bureaucratic regulations than in the western parts of China. Against this background, we have already decided early in the 90-ies to invest next to our sites at Shanghai also in Lanzhou.

Our expansion in this region is meant to contribute that the Chinese success story of Netzsch can be continued.

About the Netzsch Group Business Units, at a Glance

The Analyzing & Testing, Grinding & Dispersing and Pumps & System Business Units are independently-operating entities with the objective of always offering their customers an optimally tailored solution to their specific needs.

Analyzing & Testing

Instruments and systems for thermal analysis for the complete material characterization of raw materials and finished products in the areas of research, development and quality assurance. These versatile methods are used primarily in the plastics and rubber industries, as well as in the chemicals, pharmaceuticals, foods and paints industries, and in metallurgy, construction and ceramics.

Grinding & Dispersing

Grinding systems for wet and dry grinding as finely as the submicron range. Mixing and dispersing system for solids and suspensions. Planetary mixing systems and press out for highly viscous products. Broad application ranges in a great variety of industrial areas, from chemicals – such as paint and lacquer manufacturing – to the minerals, pharmaceutical and foods industries. Plastic recycling plants.

Pumps & Systems

NEMO® Pumps are employed in all kinds of industrial processes – primarily in the branches of environmental protection, food and drink, chemicals and raw materials, and crude oil – for conveying nearly all types of media from A to Z.

Source: Börsen-Zeitung Spezial, Frankfurt am Main, Germany, October 13, 2015; www.netzsch.com. Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

Speech Frankfurt am Main I 20.11.2015
Dr Jens Weidmann President of the Deutsche Bundesbank

How to address the euro area's economic challenges?

Keynote speech at the 25th European Banking Congress

1 Introduction

Ladies and gentlemen

It is a great pleasure for me to speak to you. As I stand before you today, it's hard to believe that a whole year has already gone by. I don't think that there is any event I've attended more regularly - with the exception of the Bundesbank's presentation of its annual accounts.

At last year's event, I suggested that contemporary banking and medieval banking have as much in common as a Ferrari and a donkey cart.

What holds true for a subsystem of the economy certainly must hold for the economy at large. In terms of complexity and sophistication, today's economy and its medieval counterpart are worlds apart.

This, however, raises an obvious question. If the euro-area economy really is a sleek sports car, why has its performance been decidedly less than dynamic? Is the engine sputtering? Have the tyres lost pressure? Does the body produce drag?

The answer to these questions is: all of the above. The euro area's growth engine is not firing on all cylinders. The euro area's tyres have lost pressure - that is, Europe's banks have reduced their leverage. And although the lowering in the form of fiscal consolidation has been crucial to prevent the euro area from careening off the road, at the same time, the reduced ground clearance makes it harder to cushion bumps - meaning that it may become more difficult to respond fiscally to negative economic developments in the euro area.

To counter all this, monetary policy in the euro area has put the pedal to the metal. It has lowered interest rates into negative territory, and it has embarked on large-scale asset purchases for most sovereign bonds.

But while monetary policy has certainly provided a boost, growth is generally considered to be only moderate.

So, what is needed to return to cruise speed? Can we overhaul the engine for better performance? Does it make sense to top up the tyres with air? Should we try to eliminate the fiscal downforce? Or should monetary policy try to push the needle even closer towards the rev limiter?

In the next 20 minutes, I will explore these options in turn, starting with the engine overhaul, that is, with structural reforms.

To the top

2 EMU's growth engine

The European Commission estimated in 2013[1] that the euro-area medium-term growth prospects - in other words, the growth rate in the next ten years without any additional reforms - is only 1%. These figures would hardly earn you a place in the heart of a young Top Trumps enthusiast.

What's more, one might argue that a lot of potential in terms of structural reform has already been unlocked, especially in the countries worst hit by the crisis.

And indeed, much has been done to correct the macroeconomic imbalances that are at the root of the struggle the euro area is facing. The divergence between prices and wages on the one hand and productivity on the other was the driving factor behind the current account deficits. These deficits had to be financed externally and gave rise to the precarious levels of public and private debt.

Prior to the crisis, current account deficits in Spain stood at 9½%, in Portugal at 12% and in Greece at a remarkable 14½%. When markets refused to continue financing the deficits at longer-term bearable interest rates, the gap had to be closed. The financial support provided under the rescue mechanisms and our common monetary policy have smoothed the adjustments - without these measures, the adjustments would have been far more abrupt.

Still, adjustment had to happen, and the reforms undertaken so far have facilitated these adjustments. Wage negotiations, for example, have been decentralised and wage indexation has been abolished or reduced - Spain is a case in point. This makes it possible for wages to take the specific situation of each firm into account and to make firms more flexible in their response to economic shocks. As a consequence, unit labour costs have gone down by 18% in Ireland, 5% in Spain, 4% in Greece, and 1½% in Portugal.

Prices and wages have been brought more into line with productivity. This will allow all crisis countries except Greece and Cyprus to switch external deficits into surpluses in 2015. As a result of the ongoing restoration of competitiveness, the euro area has now been placed on a sounder footing.

But while competitiveness is necessary for growth, it is in itself not enough. Ultimately, growth hinges on productivity. This is where we now have to redouble our efforts. Not doing so would mean "taking the pain but missing out on the gain", as Benoît Cœuré has aptly put it. The structural reforms that are now needed are the ones that unleash innovation and propel productivity.

We also need them now because these are the reforms that can credibly raise expectations of a higher income in the future. And if income is expected to be higher tomorrow, investments will be made today. Reforms that increase supply will thus support demand as well.

The willingness to invest depends on capacity utilisation, which is recovering gradually in the euro area, the level of funding costs, which is low due to the ultra-loose monetary policy, and predominantly on expectations about future growth. Without profitable investment projects, lowering funding cost will not go very far in stimulating the economy.

Hence, the key question is: what actions are required to brighten the euro area's growth prospects? Structural reforms are mostly grouped into product market and labour market reform. In both areas, there are still many gains to be reaped. Progress in these areas would strengthen productivity by making it easier to shift production factors to areas of higher yield. And by the same token, it would improve countries' ability to adjust to unforeseen economic events and structural shifts like digitalisation in the future.

To the top

2.1 Product market reform

To paraphrase Tolstoy: when it comes to productivity, every unhappy country is unhappy in its own way. There is therefore no "one size fits all" approach best suited to increase productivity everywhere. Some countries need a greater focus on product market reforms, while others need additional efforts regarding labour market reforms or cleaning up bank balance sheets. And countries like Greece are also in urgent need of administrative reforms.

Nevertheless, I will try to make some suggestions. My list is by no means exhaustive, but perhaps it can serve as food for thought in the discussion to follow.

Let me start with product market reform. A bigger market makes it more attractive for any potential entrant to compete in it. And more intense competition spurs innovation. In the long run, innovation as a result of increased competition is the main reason why market integration raises welfare.[2],[3]

But for newcomers to be able to challenge incumbents, they must not trip over red tape. Unfortunately, bureaucratic barriers to setting up a business are still high in many European countries - not least in Germany, which ranks 107th in the World Bank's Doing Business report in this regard - interestingly, a rank it shares with Antigua and Barbuda. This implies a considerable distance to the frontier of best practice. In New Zealand, for example, establishing an enterprise only takes a single official contact.

How large is the impact of barriers to entry on the overall economy? Research suggests it is quite large indeed. Raising entry costs from very low levels such as those observed in Denmark, for example, to moderate levels like those in Spain might reduce per capita GDP and total factor productivity by up to 10%.[4]

And the small differences in the administrative cost of entry between Europe and the US seem to explain 10 to 20% of Europe's lag vis-à-vis the US with regard to total factor productivity and the capital-output ratio - even though such quantitative estimates always have to be taken with a pinch of salt.[5]

To the top

2.2 Labour markets and productivity

Barriers to market entry can exert a powerful drag on productivity. But there are other factors in play as well. On average, bigger firms tend to be more productive and are better placed to compete in export markets. Unfortunately, the growth of small, innovative companies is hindered in some European countries by a plethora of regulations that kick in at a certain size threshold.

In France, for instance, many regulations become binding when a firm reaches a size of 50 employees. This causes some firms which would otherwise expand to stay below that level. Research[6] suggests that this distortion might lead to a loss of 4-5% of French GDP.

Size-contingent regulations exist also in other countries especially in Portugal or Italy. What these regulations all have in common is that they deter firms from expanding. In other words, they are a drag on growth.

By the same token, tearing down the still existing barriers to a common services market and a common digital market in Europe holds the promise of doubling the gains achieved by integrating goods markets.[7],[8]

In Germany, for example, this could imply an additional 400,000 jobs over the period 2015 to 2020.

But reforms at the European level alone will not suffice to master Germany's looming challenge - its demography. To counter the dampening effects of the demographic development, we have to boost employment by increasing labour force participation, by allowing for labour market-oriented immigration, and by improving the integration of long-term unemployed.

The immigration of refugees can also provide opportunities for growth in Germany over the medium term. To seize these opportunities, however, requires decisive policy action - among other things, mainly efforts to ensure labour market integration. That means language courses, improving school education, and vocational training.

But we should be realistic and not create undue expectations. Experience suggests that integrating refugees into the labour market will take time. In the end, immigration can alleviate our demographic challenge, but it cannot solve it completely.

To the top

3 Bank leverage

As we have seen, the euro-area growth engine can still be tweaked in quite a few ways. But what about reducing rolling resistance by reflating the tyres, for example by turning back the clock on regulatory reforms to allow for more leverage?

Regulation is a Goldilocks issue. It appears that there is - like the tyre pressure - such a thing as an optimal degree of regulation. Regulation below that level, as in the pre-crisis era, greatly increases vulnerability, without doing much in terms of sustainable growth. If regulation goes too far, however, viable firms might not get the funding they need.

I would argue that the deleveraging process that has taken place so far in the euro area has largely remained within the safety zone.

Sufficient capital buffers are crucial - and for large international banks they will have to increase further with the recently adopted requirements for bail-in-capital (TLAC) - but so is regulatory certainty, which is why I am in favour of bringing Basel III into full effect next year rather than conveying the impression that regulators are already working on a possible Basel IV.

Equity is costly, which is why exceedingly high capital requirements might unduly curtail bank lending. But equity is costly partly because of the preferential tax treatment of debt, which is why I am in favour of doing away with it.

Furthermore, the recent credit developments do not suggest that the new capital requirements constrict lending on a lasting basis. Since last autumn, lending to non-financial corporations has recovered perceptibly in the euro area. And Bundesbank research[9] suggests that the factors that hamper credit developments for example in Spain and Italy, such as the private sector's attempts to reduce its debt overhang and the high levels of non-performing loans in banks' balance sheets, have abated markedly.

Of course, this recovery is also partly due to monetary policy measures like the TLTROs, which specifically target credit provision.

To the top

4 Fiscal policy

If increasing the air pressure of the tyres beyond that optimal level would be a dangerous proposition, what about eschewing fiscal consolidation? Is this a viable option for providing a boost? To anticipate the answer: no, it is not.

A number of euro-area countries have consolidated their budgets since the outbreak of the sovereign debt crisis. Critics such as Paul Krugman and Joseph Stiglitz have charged that this consolidation has caused more harm than good, as spending cuts and tax increases served to dampen already weakened aggregate demand even further.

Consequently, they are calling for a loosening of the euro-area fiscal stance. But for many countries without fiscal space, that is simply not an option if we do not want to return to the days of 2011 and 2012, when doubts about the sustainability of fiscal policy led to very high interest rates in some euro-area countries. This leaves the countries with fiscal space to raise spending, Germany among them.

However, the periphery's share of German imports is very low, which suggests that spillovers would remain modest - all the more as the import content of public expenditure is especially small.

What is more, incurring additional debt in one member state to stimulate demand in another is a level of fiscal coordination beyond what is provided for in the current institutional framework of the monetary union.

To put it bluntly: this request by some countries would not be consistent with the insistence of the same member states to decide nationally on their budgets - which even goes so far as to reject the mutually agreed obligation stemming from the Stability and Growth Pact.

As debt totals more than €2 trillion and demographic challenges will continue to loom large, Germany should use the opportunity of low interest rates to reduce the debt burden. In that light, pursuing slight budget surpluses makes perfect sense. This holds also because safety margins vis-à-vis deficit ceilings help to buffer unexpected fiscal shocks as we see now, for instance, with the migration inflow.

Germany's future challenges, however, make some changes in fiscal policy advisable. Where Germany's growth potential is concerned, there is consensus that higher public investment does have a role to play.

The size of the investment gap, however, is probably more difficult to gauge. National definitions of public investment differ, which is just one reason why a European average is a flawed benchmark. In the end, it is important that all investment measures are judged on a case-by-case basis, as we have seen in the past that not all public investment measures were money well spent.

And we should focus on shifting priorities in public expenditures. In Germany, for instance, there is no need for a debt-financed fiscal stimulus, as the economy already shows a high level of capacity utilisation. But there is a need for a structural shift of government expenditures from consumption to investment in infrastructure and education. Reforming the financial arrangements among the federal level, the states, and the municipality level could encourage that shift.

To the top

5 Monetary policy

Ladies and gentlemen

While monetary policymakers obviously care about real economic developments, the recommended speed they try to maintain is a nominal variable: inflation.

And there's no denying that the clock shows we are currently running below target.

The question is this. How should the Eurosystem act in this situation? Inflation rates in the euro area have been significantly below our definition of price stability for some time now, that is, a level of below but close to 2%. And it is expected that inflation will return only slowly to that level.

An excessively prolonged period of low inflation is clearly not without consequence. It could place a strain on the sustainability of private and public debt in some countries and complicate the economic adjustment process for countries which have lost competitiveness.

And if interest rates are near the lower bound, lower inflation might translate into a tighter monetary policy stance than warranted, in particular if longer-term inflation expectations are affected.

But that is not the end of the story. What also matters is the nature of the inflation shock. At the moment, the sharp fall in energy prices is what is mainly driving the low rates. This drop has pushed down headline inflation by about one percentage point. Correspondingly, the core inflation rate stands at 1% and should gradually increase towards our definition of price stability, which is - let me remind you - a medium-term concept.

Crucially, the decline in oil prices is more of an economic stimulus for the euro area than a harbinger of deflation.

Lower oil prices reduce energy bills for both households and firms. That frees up financial resources which can then be put to use elsewhere - for consumption, investment or for reducing the debt overhang. All of this is good for the economies of the euro-area countries.

At the same time, it seems that the downward risks stemming from international developments have increased somewhat. And uncertainty has risen more generally, as massive migration flows will also leave their mark on the economy. But while the quantitative effects of migration are hard to estimate precisely, it is safe to say that their impact on GDP will be rather stimulative over the projection horizon.

All things combined, I see no reason to talk down the economic outlook and paint a gloomy picture. Rather - and despite all this uncertainty - our forecasts were not far off the mark.

In the end, we should also not forget that the monetary policy measures already taken still need time to fully feed into the economy.

And we need to be aware that the longer we stay in ultra-loose monetary policy mode, the less effective this policy will become and the more the attendant risks and side-effects will come into play - take the exuberance in some financial markets and the problems faced by life insurers as examples. And we should not ignore the risk that fiscal policy could get used to the very low interest rates - leading to a situation in which consolidation efforts peter out and where monetary policy might come under pressure from governments to continue accommodation even if monetary tightening were called for.

To the top

6 Conclusion

Ladies and gentlemen, let me conclude.

While growth has recovered somewhat from the fallout of the crisis, it is still less than impressive. But the way to higher growth does not lead through cosmetic changes and quick fixes. We will only get there if we tear down the still existing barriers to product, services, digital, and labour markets and include those who are currently sitting on the economic sidelines. And even then, we might not completely reach the speed of pre-crisis years, as those were driven by unsustainable growth in leverage.

If the euro area is to be converted back into a sleek sports car that turns heads in the street, a lot of engineers still have a lot of work cut out for them.

Thank you for your attention.

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Germany, Article: “The Subject Software is Being Decided by the Truck-Producers””

The CFO of SAF-Holland about reputational risks after the VW-affair, the financing of new growth targets and the interest on the stock exchange candidate Jost

Article provided by GEFIU, Association of Chief Financial Officers Germany

Mr. Trepels, the VW group has to save money. Will that also hit the business of SAF-Holland which is delivering fifth wheel couplings for truck-producers like Scania, MAN and VW utility vehicles?

Almost 85 % of our business is made in the market of trailers and the aftermarket. Just around 15 % is attributable to products for trucks as well as busses. Our sales share with the truck-producers mentioned above is up to 1 % of our group revenue. On that ground alone, we are not expecting great impacts.

The VW-manipulation of exhaust emissions is damaging the reputation of Made in Germany. May this have a negative impact on SAF-Holland which has made two-fifth of its turnover in North-America?

Firstly: We are not an automative supplier. Also therwise, we are not producing engine parts and are not affected at all by the latest discussions about diesel-oxide emissions. Since 2006 – the merger of the former German Otto Sauer Achsenfabrik with the US American Holland Group - we are an US-company in the United States, in so far I cannot see any risks. Concerning our products, people 8in the USA are not talking about a fifth-wheel coupling, but they are talking about a “Holland”, comparable with “Tempo”, the epitome of a handkerchief. Concerning our branch, the company Holland has a name, in the USA, like a clap of thunder . We are using this for our branding as well.

The fifth-wheel couplings are still sold by the name Holland, the axes by the brandname SAF. We are pursuing the approach of a multi-branding-strategy and endeavor to develop the strength of the single brands.

The commercial vehicle industry is under similar pressure as the automobile industry concerning the requirements of the authorities and regulations. How does this impact the business of a supplier?

Let us take regulatory requirements as an example, which are in force since August 2013 in the United States and which are demanding a reduction of 30 % of the breaking distance of heavy trucks and trailers. It is important to know that in the United States, most of the trucks and trailers are provided with drum brakes. You cannot imagine this in Europe at all, here you will find that only few single applications in the offroad-sector which are running with drum brakes. Besides, everything in Europe is running with disc brakes because this is the better and more efficient solution.

So, since 2013 there is no keeping back for SAF-Holland disc breaks in the USA?

In deference to the domestic, quite conservative fleet-producers, the American legislator did not commit itself exclusively on the disc technology in 2013. In the long term, however, the technology will prevail, and we are already feeling positive impulses because the pioneers in the industry also in the USA let already install disc-brake trailer-axels also. In the USA, there exist great fleets as for example the supermarket-chain Meijers which is using hundreds of trailers having tested disc-break based axels on their vehicles since years. So, the change is beginning slowly, but surely. Actually, we are still growing with drum-break axel-systems in the USA.

Another topic which is meanwhile preoccupying the regulatory authorities in the EU is also dealing with braking distance. What do you think about the debate on “monster-trucks”?

The combination of trucks with long trailers – about which also in the EU one is considering – would not lead to a sale of more axels in terms of numbers. But as this kind of driving is more economical and leads to competitive advantages for companies, a boom would be initiated. Forwarding agents with the necessary funds would try to skip from the standard-trailer to the mega-trailer relatively quickly. This would certainly create a very nice demand on new vehicles and axels.

Do emission limits play also a role for a supplier of the truck industry, then?

So far, the combustion engine is in the focus of the regulator concerning the limitation of carbon dioxide emission, also in the commercial vehicle industry. In a further step it would be logical, though, to relate the CO_2-emissions to the combination of truck and trailer. Because the 30 tons are staying behind. The regulator is requiring a reduction of weight for quite some time now, but is focusing on the truck thereby. This can apply to the trailer as well. I can build a lighter trailer which is reducing the consumption of Diesel and can significantly reduce the emission of pollutants. But this is not yet embedded in our legislation.

In the last days, we learnt that the software is playing a more and more significant role concerning combustion motors. Which amount of attention is attached to software by SAF-Holland for the future of own products?

We have intensively analysed the question how far electrical engineering will change our business, and if yes, where to find starting points for us. At the end, we have concluded that – with a view to trailers attached to trucks – this will be a topic taking place via the EBS (Electronic Breaking System). We are of the opinion that the truck-producers are unwilling to lose out as they are the biggest players in this market. There are about 10 truck-producers worldwide, but then there are hundreds of trailer-producers. On third place there are suppliers as us, who are delivering non-steered, none-driven axels in which are integrated sensoric functions. But the topic software and on-board-diagnosis will be decided by the truck-producers. There, all data is collected in the driver's cab and is already connected today.

There will be no big-data-processing for the monster-truck by SAF-Holland also in future?

The topic is relevant, but as a supplier of suspensions and axels, we will not play a decisive role. There are competitors who are dealing with the subject of telematics. After thorough testing we are not of the opinion that this may be expedient. Trailer-producers are already offering own telematic-solutions which are referring to the trailer, though. There are useful approaches because the trailer is independent from the truck in principle. But at the end there is the truck-producer who will read out the data. In our view we will have to continue investing in our core business as a suspension manufacturer. There you can also find a guarantor of our success.

SAF-Holland has set ambitious new goals to 2020. Do you have the necessary resources for the expansion plans or will you use the favorable financing environment soon?

Very clear answer: Yes, and this is only consequential. Our target is to grow from more than 1.0 billion Euro turnover in the present year to up to 1.5 billion Euro in 2020. To reach this, we have set up 64 business plans for 8 regions and 8 product lines. Based on this, we have defined 8 growth initiatives. So, this strategy is not only painted on paper, we are, decidedly, on a way with our business plans and are convinced that we will be in a position to produce 250 million Euro additional turnover by ourselves until 2020. But we will need additional resources for this and will recruit for about 140 new employees in the segments of engineering, service, sales as well as application-engineering within the next five years. Furthermore, we are expecting additional investments by the amount of a total of 42 million Euro. This will be done with our own cash-flow, though.

And the other 250 million Euro?

We like to achieve the second part of our growth-strategy, the second additional turnover of 250 million Euro, by supporting cooperations, joint ventures and acquisitions. These have to be co-operations which help us to find strong partners in countries in which we are not yet represented that much, such as in the Next 11 (Egypt, Bangladesh, Indonesia, Iran, Nigeria, Pakistan, the Philippines, Mexico, South-Corea, Turkey and Vietnam) so that we are in a position to put on their infrastructure with our technology. Another approach will be to look for partners with a view to components to expand our after-market-business which is already supported worldwide by more than 9000 distributors of spare parts today. Here, we are especially talking about financial resources, but we need also further management-resources as we have to integrate.

How many funds you will have to collect to buy a turnover of 250 million Euro?

You have simply to look t this in in a mathematic way. If we will additionally purchase 250 million Euro turnover by preferred smaller acquisitions, we will need about 200 million additional financial resources for that. On the one side, we are having a look on the world and are processing our long- and short-list consequently. On the other side we have to see that we are ensuring our financing, and do not fall into a hen and egg situation. Furthermore, the interest rates are still low. I think we can see in the next months that the company will align accordingly.

Does also the name of the competitor Jost show up on your short-list, who's stock exchange plans disappeared in the latest environment as one hears from financial circles?

Here, I can trace back to the year 2008 when we were planning for the next step after the merger of SAF and Holland. Already at that time Jost was for sale, and in this context we have intensely dealt with it and had also made an indicative offer. At the end of the day, Jost was sold for quite a high price to another investor group, and for quite a high price as per our view.

New chance, new luck?

On an ongoing way, we are dealing with potential targets in our industry and we are analyzing this, also the mentioned corporation. Options for financing had existed. However, the valuations and competition matters play a significant role with a view to the often high market shares.

So the subject Jost is finished for SAF-Holland with this?

We have not participated in the contest. I am not a friend of running into a risky investment and then trying to fulfill the regulations of antitrust authorities. This I would like to know before.

Let us go back to the financing side. Besides growth financing, will you take first actions to the next phase of refinancing?

Classical refinancing steps will not take effect. The bond which we have issued two years ago for 75 million Euro and which is due in April 2018, is running so well that nobody wants to sell it before maturity. In addition, we have issued a convertible bond by a volume of 100 million Euro over a year ago. Here, we have no opportunity to finish this financing either. It's up to the bondholder alone whether he/she converts what he/she can do anytime, but will probably do in autumn 2020 at the latest.

What about the credit line of about 110 million Euro which is contracted until 2019?

We are thinking about reworking the existing credit agreement with the banks. The times are rsuch that there are possibilities. On the one hand, this relates to the entire contract-construction, on the other hand also to the contract-conditions, although our conditions are already well and large leaps are not expected here.

Will you walk again on this way for the financing of your growth targets after the good experiences with a bond issue in the Prime-Standard-Segment 2012 or can you imagine a renewed increase of equity?

This was lately made by way of issuing a convertible bond. The equivalent in shares is around 8.1 million shares; not a negligible number at a total of 45.4 million existing shares. Therefore, we will not walk in this direction any more.

At last, the equity quota was at 40 %. Do you intend to keep it in the phase until 2020?

Yes, this target mark continues to exist as well as our dividend policy that 40 to 50 % of the available profit is paid out. In phases of growth, the potential of availability is certainly not that high. We will look at this from year to year, with a view to a sustained policy which is important to us. At the end, there remains up to 60 % of the net result which we will add to the equity in the company. That means equity growth by ourselves.

After the first half year 2009, the equity quota of SAF-Holland was at 10.5 %. Before, the business had collapsed during the financial and economic crisis. Are you better prepared for external shocks today?

The sensitivity for market changes is much stronger in the entire industry. In 2009, we had not only to fight with the consequences of the in my mind biggest economic crisis since 1928, but also the truck- and trailer-industry continued to maintain production unchecked the months after the beginning of the crisis. When the entire degree of the downturn became clear, the courts of the producers as well as of the dealers were full. The more intense the market descent became. In the autumn of 2008 one of our largest customers on the truck-end produced 4 trucks in the entire quarter.

SAF Holland Share Price versus German DAX 30 Index

As of January 12, 2015
SAF Holland Share Price 11,53 EURO, p/e ratio 9,29, dividend return 4,45 %

What has changed since then?

We have intensely worked on how to improve our visibility. In general, our visibility reaches for 6 weeks. This is not much. So, we are interviewing our larger customers regularly in an institutionalized process about the sentiment of the industry. This is done in Europe as well as in the USA which together account for almost 90 % of our business. In addition, our direct customers provide us regularly with sales data which are utilized with regard to the availability for materials and our production planning for a period of two weeks. Our view to sales and delivery is more professional and more institutionalized as before the crisis.

Have you also turned at the cost screw?

In the last years, we have closed four factories respectively merged them with other sites into greater sites in order to save costs and to optimize the processes. One will follow in addition this year. In Europe, we have made an agreement with the workers council and the labour unions that a fifth of our staff can be used variably. We are applying time limited employment agreements and employ temporary employees, and have a system of flexible working hours accounts. Everything that is going beyond the regularly working hour scheme is booked and retained on these hour-accounts and it is decreased in times of weaker periods.

But the business depends strongly on the economic activity?

Concerning the product-side, we have built up new schemes, which are less cyclical. To this belongs, for example, the busses-business of our Chinese subsidiary Corpco. Then if China is growing by 3, 4 or 7 % it will be irrelevant for the essential mobility requirements of the people there. Furthermore, we are enlarging the spare parts business. This segment is planned to generate a quarter of our sales until 2020. All this is making us crisis-resistant, because the forwarder agents hold on to their vehicles in harder times and invest in spare parts.

Also regionally, SAF-Holland will be present in a broader way. Until 2020, a third of turnover is planned to be achieved outside the core-markets Europe and North-America. Is this also possible when China continues to be in a weak mode?

In China, we want to grow in a sustained manner, but we are not striving for a 30 % market share here, like in other countries. The market is so large, 5 % we would like to reach in the medium-term. This is achievable, also if the total market is not growing strongly. Nevertheless, SAF-Holland can conquer market share, because also in the Chinese truck-market the view is changing, and subjects like quality, comfort or CO_2-emissions are becoming more important. Market analysts expect that in the next years, the truck-fleet in China will be changed over to Western standards. But when air suspensions and disc-breaks will become standard in the truck, then also the trailer-fleets must be changed over. There exists a great potential for us, also when the Chinese economy is not growing any longer with 7 %.

How is the situation with regard to the investors? Do you want to broaden here regionally either?

In the USA and Canada we are making progress with our investor relations activities. We are just coming back from a road show at Toronto, Chicago, Boston and New York. In China, we want to participate together with a large bank in a small-&-mid-cap-conference for German corporations next spring. Still in the current year we will go to Australia. We are interested in this because truck & trailer as an industry is very popular in Australia. At the moment, though, the market is difficult there because the national economy is impacted by the crisis in the base material industries.

And how is business running for SAF-Holland presently?

We are satisfied with the business mode. There are regional differences as well as in the development of single business units. Overall, the business is running well. The nice thing is that we are in a position to equalize market differences at a group level, because we are advancing with several business units in various regions.

The interview was conducted by Stefan Paravicini

About Wilfried Trepels, the "Truck"

10 years ago, Wilfried Trepels (51) went from the automobile supplier corporation Dürr as CFO to the former Otto Sauer Achsenfabrik GmbH, headquartered nearby Aschaffenburg, Germany. Customers were especially producers of truck-trailers, the new CFO, however, had personally to move immediately into the truck in the figurative sense. Since 2005, the corporation has made several acquisitions with Trepels in the driver-cabin and after the takeover of the US-competitor Holland in 2006, the corporation changed its name into SAF-Holland. In 2007, the corporation mastered the going-public, at which the investor Pamplona Capital Partners sold shares to the market. Before, Pamplona Capital Partners had acquired its shares in the corporation from the Deutsche Beteiligungs-AG.

In 2010, when Pamplona totally withdrew, Trepels had brought SAF-Holland back into a safe financial structure after the great turbulences of the financial and economic crisis. From 300 million Euro turnover with 900 employees in 2005, SAF-Holland since has developed itself into an S-DAX-index-member company, and into a consolidated-group with 1 billion Euro turnover and 3.500 employees.

from Börsen-Zeitung, Frankfurt am Main, Germany, October 10, 2015. Responsible for translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel

Speech New York City | 04.12.2015
Dr Andreas Dombret Member of the Executive Board of the Deutsche Bundesbank

Firm as a rock - is bank capital an all-purpose tool? The example of sovereign debt regulation

Public Speech at Columbia University

1 Introduction

Ladies and Gentlemen

Thank you for giving me this opportunity to speak at Columbia University. It is a pleasure to be here again. It is always inspiring to participate in such an academic environment. I was here three years ago and fondly remember talking to students.

When I was here last in November 2012, I talked about the crisis in the euro area. At that time, the topic was a good pick. Since then, much has happened in terms of regulatory and supervisory reform in Europe. One prominent example is the creation of the European Banking Union, which aims to introduce a supranational perspective into European supervision. We have, since November 4, 2014, created a Single Supervisory Mechanism and the Single Resolution Mechanism will follow in less than a month. The ECB here assumed responsibility for supervising - in cooperation with national supervisors - about 120 largest banks in the euro area. These banks account for more than 85% of the aggregate balance sheet of the euro area's banking sector, making the ECB one of the biggest banking supervisors in the world. The Bundesbank very much supports this development.

Ladies and gentlemen, one prominent Columbian, as you call yourselves, was Theodore Roosevelt. He once said: "In any moment of decision, the best thing you can do is the right thing, the next best thing is the wrong thing, and the worst thing you can do is nothing."

For regulators, the crisis definitely constituted that moment of decision. And for sure we cannot be criticised for doing nothing. Time will tell whether we did the best - i.e. the right - thing. For my part, I am convinced that we did many things that were both worthwhile and right.

To the top

2 Different traditions, but ...

When you think of financial crises, one of the first ideas that come to mind is the need to make banks more resilient. And one key factor in enhancing the resilience of banks is to strengthen their capital base. I will return to this point later on.

When talking about capital and credit, it is quite obvious that there are different traditions in the United States and in Europe. While financing in Europe - with the exception of the United Kingdom - is still predominantly bank-based, the US tradition is much more market-based. Economists have debated which system is superior for decades, if not for centuries.[1]

This is neither the time nor the place to repeat the whole debate about advantages and disadvantages of the respective systems. Allow me, however, just to name some significant points of the discussion. There is empirical evidence to suggest that market-based systems react more procyclically than bank-based economies because of more pronounced asset price booms and busts.[2] However, bank-based systems are also beset by procyclicality. A study conducted by the Bank for International Settlements has shown that, while bank-based systems are more effective at smoothing the impact of business cycle fluctuations, market-based economies recover more quickly after crises.[3]

Leaving aside the pros and cons of the two systems, it is my strong belief that the question of the proper financing source cannot be answered with "either/or" but has to be "both". In the end, it comes down to the uncontested argument of diversification. And the answer is highly dependent on the context. In Europe for instance, the bank-based system reflects the corporate structure of the economy - there are many small and medium-sized entities, the so called SMEs. And - like in the United States - the SMEs tend to favour bank-based financing, if only as necessity because there are barriers for small companies to obtain market financing.

Against this backdrop, I very much appreciate the European Commission’s efforts to establish a European Capital Markets Union. By making it easier for small and medium-sized enterprises to access the capital markets, we could open up a further source of funding for them. To make one point clear: Referring to what I said before about "either/or", the objective of the European Capital Markets Union is not to abandon bank-based funding but to supplement it with capital markets-based funding. And in Europe of all places there is plenty of scope to do so. The European stock market is only 60% of the size of the US stock market as measured in relation to GDP. Similarly, the European market for venture capital is 20% of the size of the US market, and for securitisation the percentage is even lower still.[4]

To the top

3 ... capital matters: regulatory reform after the financial crisis

Although we represent different financing systems, one point is essential for both. Capital is a main starting point for safeguarding the strength of banks as well as financial stability. Resilient capital markets need resilient banks as key players in the financial system. And resilient banks need capital - or rather equity - in order to be able to absorb negative shocks. And this is where regulation comes into play.

One of the main lessons of the financial crisis was that the rules governing the banking system were insufficient. We saw excessive risk-taking, insufficient loss-absorbing capacity and banks that were "too big to fail" - to name just a few of the problems that led us into the crisis.

Over the seven years since the collapse of Lehman Brothers, significant progress has been made on the regulatory agenda. The most important regulatory measure was the Basel III framework, which introduced stricter capital requirements and new liquidity rules. In the EU, CRD IV and CRR, the relevant directive and regulation, ensure harmonised implementation of the Basel III framework across all member states.

When Basel III is fully implemented in 2019, regulatory capital requirements will be significantly higher and capital will be of higher quality than under Basel II, and I am convinced that the financial system will be much more stable than before. The calculation is quite simple: More equity that can absorb losses makes banks safer. Besides, more equity on the one hand strengthens the interest of the bank owners in good risk management and on the other hand reduces possible losses of debt holders should the bank be faced with default.

To the top

4 Capital is not the panacea - the example of sovereign debt regulation

But are higher capital and liquidity requirements enough? Certainly not. And therefore, many other regulatory projects besides the Basel III regime have been tackled in response to the financial crisis. Let me discuss one example that I believe to be a very good illustration of the limits of capital as an all-purpose tool: The regulation of sovereign exposures.

A problem that unfortunately became apparent during the European sovereign debt crisis was the close nexus between states and banks. Under the current regime, banks do not need to hold capital against the risks associated with loans to sovereigns - unlike any other loans. This is based on the assumption that loans to governments are risk-free because states cannot default, rendering capital buffers unnecessary.

All those who had trouble following this line of risk-free-debt argument saw their doubts confirmed by the sovereign debt crisis in Europe. It became obvious that we need to rethink the assumption that loans to governments are risk-free. In actual fact, sovereign risk is a cluster risk because the default of a sovereign as single debtor can well cause bank insolvency. Given the amount of home country sovereign debt that some banks hold - which sometimes exceeds their equity - a possible restructuring of sovereign debt may well threaten a whole national banking system.

Consequently, changing the rules appears imperative. If banks were required to hold capital against the risks of their government bond portfolios, they would be more resilient to fiscal distress. At the same time, banks would have less incentive to buy large volumes of government bonds if these were not privileged any longer. Furthermore, this may incentivise governments to reduce their debt.[5]

And this brings us to the second issue: Capital alone is simply not sufficient. A crucial tool in risk management is diversification - as specified in the Basel large exposure regime published in 2014 which will take effect from 1 January 2019. Large exposure caps prevent banks from becoming overexposed to a single borrower and the risk of its default. Currently, the regime is restricted to private borrowers, and sovereign bonds do not fall into its scope. To me, it is important to end this privilege and to create a level-playing field for private and sovereign borrowers alike. Therefore, a cap on loans to an individual sovereign is needed and should also be introduced.

Let me be very clear on this issue: Actually, I see no economic argument why banks should be the main source of funding for governments. Unlike relations with private borrowers - where banks have significant informational advantages compared to other creditors - there is no privileged information on the debt of a nation. As a consequence, I fail to see the reason why the financing of states should not mainly be a matter for the capital markets.

And I very much welcome the international community's efforts to tackle this topic: this summer, the G7 finance ministers and central bank governors identified the regulatory treatment of sovereign debt as a major topic to work on.

Also, the Basel Committee on Banking Supervision has been working on sovereign debt for almost a year now. I believe the following points to be crucial and I hope they will be addressed by the Committee next year.[6]

- First, as I argued before, the large exposures regime should also apply to sovereign debts.
- Second, the zero-weighting of sovereign exposures should be replaced by risk adequate weights and capital requirements. The calibration needs to be careful, and an appropriate phasing-in needs to be implemented.
- Third, and I find this equally important, regulation of sovereign exposures must be consistent for all credit institutions.

If we succeed in establishing a regulation consisting of these three points, I see four main benefits. First, if sovereign bonds needed risk adequate capital requirements, banks would have to take greater account of differences in the risk profiles of states. Second, countries that burden their budget in an unsustainable manner would have to pay risk premiums - this is the so-called disciplinary force of financial markets. Third, a large exposure regime applied to sovereign bonds would prevent banks from being overexposed to a single borrower. Related to that, the fourth last benefit, and this is of high importance to me as a banking supervisor - a sovereign debt restructuring would not any longer harm the whole financial system of a nation state and beyond.

The regulation of sovereign debt is one topic we must centre our attention on in the nearest future. I am cautiously optimistic that we will come to a transatlantic solution in the Basel Committee. In this context, I cannot say often enough that each regulatory project - be it Basel III or now the regulation of sovereign exposures - very much calls for international cooperation. If we do not coordinate our approaches towards regulation, we will create a fragmented financial system with vast opportunities for regulatory arbitrage. This cannot be our goal, and we need to resist any temptation of doing so.

When all is said and done, we all have the same objective: a stable financial system - of course at the national level, but it is equally important at the global level. What we have learned in the recent years is that financial distress doesn’t stop at national borders. In the euro zone we have experienced the hard way that instabilities even in small member states have the potential to put the continuance of the entire European Monetary Union at risk.

I would like, if I may, to say a few words about yesterday's decision by the ECB Governing Council. First things first: the Eurosystem staff macroeconomic projections presented give no cause for concern over the development of the euro-area economy. In fact, they confirm the view that the steep drop in energy prices is supporting the recovery of the euro area's economy. The lower energy prices also go a long way towards explaining the expected evolution of consumer price inflation.

It's clear that inflation as forecast by the Eurosystem staff will fall short of the Governing Council’s price stability target not only in 2016 but probably into 2017 as well. That's not something we should simply brush aside. But given the predominant role which the drop in energy prices plays in euro-area inflation and the extensive monetary policy measures that have already been taken - which can entail risks and side-effects of their own - I am not really convinced that a further easing of monetary conditions was necessary.

To the top

5 Conclusion

Ladies and gentlemen, since the beginning of the financial crisis, regulators have done a lot of work and thereby followed the instruction given by Theodore Roosevelt. Do you remember? - "In any moment of decision, the best thing you can do is the right thing, the next best thing is the wrong thing, and the worst thing you can do is nothing." And I believe doing nothing and expecting the markets to recover on their own would not have been an option.

I am sure that the financial system is now safer and more resilient than it was before Lehman collapsed. I do not deny that stricter regulation may translate into higher costs for banks. However, when measured against the burden that financial crises place on society, I consider these costs to be very much justified.

The post-crisis reforms are in large part finished, but some regulatory projects remain on the agenda. I strongly argue for finishing the Basel III regulatory projects by end-2016 and afterwards give them the time to take effect. The regulation of sovereign exposures is a prime example for outstanding regulatory projects. But even if we strike an agreement on this topic regulatory reform will never be complete because the financial system is evolving constantly and regulation has to keep pace. So this means that we will have to follow Theodore Roosevelt’s advice once more when he said: "Get action. Seize the moment. Man was never intended to become an oyster."

Thank you for your attention.

Footnotes

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FSB FINANCIAL STABILITY BOARD

Press release

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FSB issues final Total Loss-Absorbing Capacity standard for global systemically important banks

The Financial Stability Board (FSB) today issued the final Total Loss-Absorbing Capacity (TLAC) standard for global systemically important banks (G-SIBs).

The TLAC standard has been designed so that failing G-SIBs will have sufficient loss-absorbing and recapitalisation capacity available in resolution for authorities to implement an orderly resolution that minimises impacts on financial stability, maintains the continuity of critical functions, and avoids exposing public funds to loss.

The TLAC standard defines a minimum requirement for the instruments and liabilities that should be readily available for bail-in within resolution at G-SIBs, but does not limit authorities' powers under the applicable resolution law to expose other liabilities to loss through bail-in or the application of other resolution tools.

The FSB released for consultation a proposed standard on TLAC in November 2014 in consultation with the Basel Committee on Banking Supervision (BCBS). The final standard reflects changes made following the public consultation and comprehensive impact assessment studies. The results of the impact assessment studies are published today alongside the final TLAC standard, and the BCBS has today separately released a consultative document on TLAC holdings.

Mark Carney, Chair of the FSB said "The FSB has agreed a robust global standard so that G-SIBs can fail without placing the rest of the financial system or public funds at risk of loss. This new standard, which will be implemented in all FSB jurisdictions, is an essential element for ending too-big-to-fail for banks. The economic impact assessments conducted as part of the detailed policy work shows that the economic benefits of the final standard far outweigh the costs."

G-SIBs will be required to meet the TLAC requirement alongside the minimum regulatory requirements set out in the Basel III framework. Specifically, they will be required to meet a Minimum TLAC requirement of at least 16% of the resolution group's risk-weighted assets (TLAC RWA Minimum) as from 1 January 2019 and at least 18% as from 1 January 2022. Minimum TLAC must also be at least 6% of the Basel III leverage ratio denominator (TLAC Leverage Ratio Exposure (LRE) Minimum) as from 1 January 2019, and at least 6.75% as from 1 January 2022.

G-SIBs headquartered in emerging market economies will be required to meet the 16% RWA and 6% LRE Minimum TLAC requirement no later than 1 January 2025, and the 18% RWA and 6.75% LRE Minimum TLAC requirement no later than 1 January 2028. This conformance period will be accelerated if, in the next five years, corporate debt markets in these economies reach 55% of the emerging market economy's GDP. The FSB will monitor implementation of the TLAC standard and will undertake a review of the technical implementation by the end of 2019.

The findings of the impact assessment studies conducted by experts at the FSB, BCBS and Bank for International Settlements (BIS) are published alongside the final TLAC standard in the form of the following reports:

- Overview report summarising the findings of the TLAC impact assessment studies;
- Quantitative Impact Study report conducted by the BCBS;
- Economic Impact Assessment report conducted by a group of experts chaired by the BIS; and
- Historical Losses and Recapitalisation Needs findings report.

The impact assessment studies found that the micro- and macroeconomic costs of TLAC are relatively contained. The estimated costs for G-SIBs of meeting the minimum TLAC requirement are found to translate into increases in lending rates for the average borrower that range from 2.2 to 3.2 basis points, while the median long-run annual output costs are estimated at 2 to 2.8 basis points of GDP. The benefits of TLAC arise from the reduced likelihood and cost of crises and exceed these costs, with even the most conservative assumptions yielding estimated benefits of between 15 and 20 basis points of annual GDP.

The FSB also published today a *Resolution progress report* which provides an update on the findings from the first Resolvability Assessment Process for G-SIBs and the further work undertaken to address the identified remaining obstacles to the resolvability of G-SIBs. The TLAC standard is an important element of this work. The report also covers progress in reforms of resolution regimes consistent with the *Key Attributes* and the work underway in the non-bank sector covering the resolvability of systemic insurers and central counterparties.

The FSB published the 2015 update of the G-SIB list on 3 November.

Notes to editors

The FSB has been established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies in the interest of financial stability. It brings together national authorities responsible for financial stability in 24 countries and jurisdictions, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

The FSB is chaired by Mark Carney, Governor of the Bank of England. Its Secretariat is located in Basel, Switzerland, and hosted by the Bank for International Settlements. For further information on the FSB, visit the FSB website, www.fsb.org

BY
H.E. MA. THERESA LAZARO
AMBASSADOR OF THE PHILIPPINES IN FRANCE

Putting the Philippines in the French Radar

Sixty-seven years: this is how long it took the Philippines to have its first visit from a French Head of State.

President François Hollande made history when he visited the Philippines in February 2015. This came barely six months after our own President Benigno Aquino III visited Paris in September 2014. Prior to this was the visit of former Prime Minister Jean-Marc Ayrault to the Philippines in October 2012. In a span of 30 months, Philippines-France bilateral relations were propelled to a whole new level and the Philippines finally appeared in the French radar. For two countries without traditional ties, this was a feat to be achieved in sixty-seven years.

Philippines-France bilateral trade doubles in three years

The impact of strengthened bilateral relations extended well beyond the political arena. Its impact could be felt in the business sector as well. According to the Department of Trade and Industry, total trade between our two countries more than from USD 1 billion in 2010 to almost USD 2.5 billion in 2014. While this trade has been mostly in France's favor – the Philippines' represented France's ninth largest trade surplus in the world in 2014 – this renewed dynamism has also served the Philippines well, particularly through French investments in the country.

During the visit of President Aquino to France last year, several commercial contracts were signed in public transportation and telecommunications: two traditional French centers of excellence. RATP-Dev, together with Bouygues Travaux Publics and Alstom Transport, won contracts for the operation and maintenance and design and construction of the extension of the oldest metro line in the Philippines. Alcatel-Lucent, on the other hand, signed a contract with Globe Telecom, Inc. – one of the leading telecommunication firms in the Philippines – to improve Globe's network quality and performance and ultimately improve the level of satisfaction of its mobile broadband access customers.

The opportunities have not been reserved exclusively for CAC40 or French blue chip companies, such as Sanofi, Total, AXA, or Lafarge. Other French SMEs, particularly in the digital sector, have also established operations in the Philippines such as digital advertising firm Netbooster and training provider Proformation. Even Coface is about to set up an office in the country. The Philippines has also attracted French entrepreneurs such as Mr. Thierry Tea, former Managing Director of Airbus in the Philippines, who decided to put up his own company after recognizing the country's potential in the aeronautics industry (see article below).

The Philippines is one of the most resilient economies in Southeast Asia

All of these historic visits and business exchanges could not have come at a better time: they coincide with the fastest-growing period the country has seen in the past 40 years. From 2010 to 2014, the Philippines had an average growth rate of 6.2%. In 2013 alone, the Philippine economy grew by 7.2% despite the major damage caused by Typhoon Haiyan.

MEETING WITH...

THIERRY TEA
FOUNDER AND CEO AT PHILJETS GROUP

The Philippines, well-positioned in the aerospace industry

I arrived in the Philippines eleven years ago in October 2004. After having worked in Hong Kong and Shanghai, I joined the Airbus Helicopters Sales Department in Paris in January 2004 and quickly wanted to go back to Asia. While I first targeted China and Australia, a VIE in Sales with the Singapore regional office came up for a country I almost never heard of. At that time, the Philippines was not popular. However, I decided to jump on this opportunity.
I recall Manila had only a few young expatriates then. Most of the French in the Philippines were either retired, CEOs or businessmen who started their business 30 years earlier. It was not easy to find my place, and the business pace was slow. There were no helicopters sales from 2000 to 2004. I therefore had to work hard to sell my first helicopter. In 2005, we sold about six aircraft. I was promoted to Regional Sales Manager covering Hong Kong and Micronesia. In 2007, I became CEO of Airbus Helicopters in the Philippines. We grew a great Filipino team from 20 to 60 employees. When I left in 2012, we had tripled the turnover, sold 45 helicopters and hired two additional French VIE. As concurrent Head of Airbus Group, we positioned the group as a leading partner of the Philippines, supporting the growth of its carriers (PAL, Cebu, Seair, Air Asia, ITI) with Airbus and ATR aircraft.

From employee to entrepreneur

I always wanted to have my own business. But if you have Asian origins in France and want to be an entrepreneur, the cliché is that you either open a Chinese restaurant, a computer business or an Asian store. I joined the Airbus Group because I wanted to prove to myself that I could work and succeed in a large European industrial group. It was risky to leave the expatriate life but I was on the same path as the Philippines; we were both growing! So I decided to create PhilJets. It was an exciting time since this was when ties between France and the Philippines were growing as well.
In 2013, I started PhilJets Aero Services Inc. and acquired a helicopter operator – Zenith Air – that we rebranded as PhilJets Aero Charter. We joined the Makati Business Club, which is the equivalent of MEDEF, as well as the Philippines-France Business Council.
We quickly saw results in our industry. We used to hear about Malaysia or Vietnam, but slowly the Philippines' image in France started to look better. Although the potential has always been there, the reforms in good governance put in place by the Aquino Administration gave the economy a strong boost. There remain, however, a lot to do.

PhilJets and the Philippines' aeronautics industry

The creation of PhilJets has been possible thanks to a great Filipino team that is still today the core of our Group. To start a company in the Philippines, you need to understand the environment well, including the local laws and regulations. It takes patience, perseverance, a lot of effort and investment.
Today we are working on a new business venture, which is looking at helping other companies to either open their business or do business in the Philippines. We strongly believe that the Philippines is well-positioned in the aerospace industry so this is why we are investing in the future of PhilJets, through MRO (Maintenance, Repair and Overhaul) training and education projects.
I am convinced the Philippines can be a great hub for aerospace and aviation, but investments are needed in order to improve the industry's standards. We are therefore building a team that can contribute to this objective. Developing shared services and Business Process Outsourcing in the aerospace and aviation sectors are part of our next steps.
As for me, the next chapter in my life has just unfolded: my wife gave birth to our first child and we are happy to welcome Julia, our baby girl, in the Philippines!

During this period, the "big three" credit ratings agencies – Standard and Poor's, Fitch and Moody's – also gave the Philippines investment grade. France's own credit risk agency Coface upgraded the Philippines in 2013.

Other international organizations such as the World Economic Forum have also taken note of the Philippines. In its 2015/2016 Global Competitiveness Report, the Philippines moved up another five notches to 47th place out of 140 countries. From 85th place in 2010, the Philippines rose to 75th in 2011, 65th in 2012, 59th in 2013, 52nd in 2014 and most recently 45th in 2015 – or the equivalent of 38 notches in only five years. This makes the Philippines the most improved economy in ASEAN and across the world for the period 2010 to 2015.

In its 2015 Economic Outlook for Southeast Asia, China and India, the OECD forecast the Philippines to have the fastest growth among the ASEAN-5 (Indonesia, Malaysia, Philippines, Thailand and Vietnam) with an average growth rate of 6.2% from 2015 to 2019.

Even in the midst of a slowdown of global growth, particularly the Chinese economy, the Philippine economy remains resilient. The Philippine peso was one of the strongest in the region, compared to the Malaysian ringgit, the Indonesian rupiah and the Thai baht which have lost 9.8%, 8.4% and 6.4%, respectively. The Philippine peso has only lost 2.2% of its value for the same period.

The Philippines' secret weapon: its people

These pieces of economic good news are supported by our entry into what economists call the "demographic sweet spot". This is when the

MEETING WITH...

SEVRINE MIAILHE
MARKETING COMMUNICATION MANAGER AT RUSTAN COMMERCIAL CORPORATION

Never take "yes" the Western way

I visited the Philippines with my husband for the first time in February 1999. A few months later we moved there and started a new life that would last sixteen years.

The first years in Manila were busy raising four children who came one after the other since Manila is definitely a great place to have children. Doctors are very good and accessible; there are numerous education options with new international schools opening regularly; and the love for children is everywhere – you will always find a person to help you look after your children with absolute dedication and genuine affection.

So when our youngest turned three, using my background in Marketing and Cosmetics, I decided to go back to work. Luckily for me, Rustan's, which is the Philippines' most prestigious department store group, was the first to give me a job offer. I was given the responsibility of organizing the Cosmetics, Perfumery and Toiletries Marketing and Communication Division.

Retail is extremely competitive in general and the Philippine market is no exception. With many malls, increasing global brand presence, online offers and our customers' habit of shopping abroad, maintaining a double-digit growth every year was no easy target!

I was able to put together a team of very competent and hardworking individuals, mostly fresh graduates or on their second job. The fact that 90% of the work was done in English made it very easy for me to organize the team and work with them. Their attention to detail and dedication have been exemplary. With a clear direction and regular evaluation and recognition, we were able to create a very successful department.

A big challenge I faced was earning the respect of my other colleagues, especially since I was a foreigner. Making the extra effort to reach out and explain what you are trying to do, engaging and listening to others' point of view, receiving criticisms well and addressing everyone in a positive way paid off. I was also very lucky to work and report directly to the owners of the company. They have been very respectful and supportive of my work which has made my experience very pleasant. They invest in developing their people's talent as much as in renovating their department stores, fully aware that human resources are the heart of their company.

My advice to newcomers to the Philippines is to always to keep in mind that Asians in general, and Filipinos in particular, are very respectful and non-confrontational. It is important to never take "yes" the Western way. "Yes" just means "I am listening to you", and not necessarily "I agree with you". With this in mind, one will avoid a lot of unnecessary misunderstanding and frustration!

Now that my family and I are back in Bordeaux, what I will miss the most is the kindness of the many Filipino friends we made, their warm smile and generosity of spirit. Living in the Philippines has been a wonderful and enriching experience and I have learned to be more patient, gentle and accepting of different perspectives – qualities that have made me a better person today.

From 2010 to 2014, the Philippines had an average growth rate of 6.2%. This represented the fastest-growing period the country has seen in the past 40 years.

majority of our population – whose average age is 23.5 years old – enter their most productive years thereby fueling economic growth. According to the Governor of the Philippine Central Bank, the Philippines is the last major economy in Asia to enter this so-called sweet spot.

This is why President Aquino is making huge investments in human capital – in health, education and training – in order to empower the Filipino people and be part of the country's economic takeoff.

All over the world, the Filipino worker is recognized as competent, adaptable and dedicated. Filipinos can work in different environments, particularly multi-cultural working environments, given their facility with the English language. Their professional competence has earned for them the respect of their Asian and Western counterparts, making them much sought after in today's dynamic business.

Ms. Sevrine Miailhe, who worked for ten years in one of the Philippines' most prestigious retail stores, describes the Filipino worker in her article very well (see article in previous page).

The importance of people-to-people exchanges in bringing the two countries together

France is becoming a more active partner in developing the country's human capital. Today, there are over 60 academic partnerships which exist between Philippine and French universities, and every year, there are more and more Filipino and French students which go in exchange programs.

For the Fall semester of 2015, France welcomed over 150 Filipino students in various universities all over the country. The number of French volunteers and interns has also increased. According to France Volontaires, there are currently 75 French volunteers in the Philippines who went through their agency. There are certainly more who went on their own.

Aside from education and research, we are also working on establishing more cooperation in the fields of culture, health and migration in order to broaden our exchanges.

This increase in people-to-people exchanges is a positive one, especially since it is driven by th e youth. Attachments and impressions formed at a young age often stay with a person for the rest their life and we are happy that there is a generation of young French and Filipinos who are discovering the wealth and diversity in each other's cultures and are laying the foundation for a strong and lasting bond between the two countries.

The Philippines has entered its "demographic sweet spot". This is when the majority of our population – whose average age is 23.5 years old – enter their most productive years, propelling the country to greater heights.

Italy, Article: United Nations – Tax Developments

By Piergiorgio Valente, Chairman IAFEI International Working Committee Taxes

The United Nations held in Geneva at the Palais des Nations on October 19 – 23, 2015, the Eleventh Session of the Committee of Experts on International Cooperation in Tax Matters.

Among the key issues discussed (see: Agenda), we may also find the forthcoming update of the United Nations Model Double Taxation Convention between developed and developing Countries as well as the next update of the United Nations Practical Manual in Transfer Pricing for Developing Countries.

As far as the next updates of the United Nations Model are concerned, the following issues were addressed:

- application of treaty rules to hybrid entities (Article 1)
- the meaning of "connected projects" (Article 5)
- the meaning of "auxiliary activities" under Article 8 (Transportation)
- Article 12 on Royalties.

The Tax Committee also discussed the impact of the OECD recommendations on base erosion and profit shifting and taxation of services.

The New Services Article

A new technical services Article will be included in the new updated version of the UN Model. The new provision stipulates that technical services will be taxed in the country where they "are generated/arise" and not necessarily, where they are performed. A number of developed countries expressed their disapproval about taxing services in those cases where they are not performed in the country in which they are generated and when there is not sufficient nexus with such country, under ordinary international tax rules, such to entitle to a charge. All disagreements expressed will be included in the commentary of this new article.

Notwithstanding the above, the inclusion of the new article in double tax treaties is not expected to be implemented in the next few years, but it might be used as a bargaining tool whenever negotiating new treaties.

Counteracting Tax Evasion

In the tax evasion area, the Subcommittee on Exchange of Information submitted a Draft "Code of Conduct". Purpose of such "Code of Conduct" is to provide guidance for countries to enhance transparency and exchange of information aimed at countering international tax evasion. Following the most recent discussions, a new draft should be issued at the next October session of the Committee, such draft would also include the shared comments.

Capacity-building

A progress report was submitted by the Secretariat outlining the various publications, courses and initiatives that are being carried out to assist developing countries in improving their knowledge and expertise to manage their tax systems efficiently.

The work carried out by the UN DESA's Financing for Development Office in the area of capacity-building was welcomed, as was the release of the "Handbook on Selected Issues in Protecting the Tax Base of Developing Countries".

Set-up of Two New Subcommittees

In addition, two new subcommittees were set up:

- Royalties (Article 12 UN Model and commentary) – to work on potential improvements to the Commentary to Article 12 of the UN Model Treaty (e.g., tax treatment of industrial, commercial and scientific tools and software-related payments).
- Mutual Agreement Procedure (MAP) – to consider a review and propose updates to improve the UN Model.

Monitoring of UN tax developments within the international tax landscape is fundamental, since not all developing countries are willing to implement OECD BEPS recommendations.

The bailout lexicon

SHUTTERSTOCK

MANY FINANCIAL EVENTS AND ERAS ATTRACT THEIR OWN TERMINOLOGY AND JARGON – AND THE AFTERMATH OF THE 2008 FINANCIAL CRISIS IS NO EXCEPTION. SARAH BOYCE AND WILL SPINNEY PROVIDE A TRANSLATION AND LOOK AT THE IMPLICATIONS

New terminology regularly appears in the financial world along with an assumption that we will all magically understand the new concept.

For example, the regulatory authorities' approach towards financial institutions and 'too big to fail' has evolved as a result of the global financial crisis. Terms such as 'bank resolution' and 'bail-in' are frequently used and it is assumed everyone understands them. This article (extensively based on articles produced by the Bank of England) is intended to explain just what these terms mean.

During the global financial crisis, banks faced significant losses that reduced the value of their balance sheets to such an extent that they lost access to liquidity. This so seriously constrained banks' activities that the authorities were forced to intervene to stop banks from collapsing and taking the real economy with them. This intervention was provided in a number of ways:

- **Liquidity injections** – emergency funding to financial markets and individual financial institutions to ensure that they could continue to meet their obligations as they fell due.
- **Asset purchases** – selected asset classes, such as corporate bonds, were purchased from financial institutions to improve the liquidity of credit markets.
- **Liability guarantees** – public authorities guaranteed some liabilities, such as deposits or new/existing debts, to shore up confidence in the financial system.
- **Capital injections** – or 'bailouts' were provided in exchange for full or partial ownership of individual firms. Thus depositors were bailed out (saved) contrasting with 'bail-in' where they take losses.

In the US, 956 firms, including some non-financial institutions, benefited from some form of government assistance, amounting to date to around $617bn.[1]

In the UK, the support was more sector-wide, with specific support for only four banks, amounting to £1,162bn at its peak.[2]

Although this stabilised the financial system successfully, the cost was borne by the public sector and shareholders rather than the banks' depositors. Shareholders did lose because share prices fell

Bail-in hierarchy

Below is the order in the UK in which capital is bailed in to resolve a failed bank. Order of priority (from January 2015):

Proceeds flow down

Fixed charge holders (ie security in the form of: mortgage, fixed charge, pledge, lien), including:
- Capital market transactions (for example, covered bonds)
- Trading book creditors (for example, collateralised positions)

Liquidators (fees and expenses)

Preferential creditors (ordinary), including:
- Financial Services Compensation Scheme (FSCS), taking the place of all protected depositors for amounts up to £85,000
- Employees with labour-related claims

Preferential creditors (secondary):
- Depositors that are individuals and micro-, small- or medium-sized businesses for amounts in excess of £85,000

Floating charge holders

Unsecured senior creditors, including:
- Bondholders
- Trading book creditors (for example, uncollateralised positions)
- Creditors with master netting agreements (net position only)
- Commercial or trade creditors arising from the provision of goods and services
- Depositors that are not individuals or micro-, small- or medium-sized businesses for amounts in excess of £85,000
- FSCS, taking the place of individuals with funds invested with the insolvent firm (including protected amounts up to £50,000)

Unsecured subordinated creditors (for example, subordinated bondholders)

Interest incurred post-insolvency

Shareholders (preference shares)

Shareholders (ordinary shares)

Losses flow up

Source: www.bankofengland.co.uk/financialstability/Documents/resolution/apr231014.pdf

Glossary			
Ring fence	The separation of some aspects of commercial banking (mostly retail) into a separate entity to reduce the probability of failure.	**BRRD**	Bank Recovery and Resolution Directive (European law).
TLAC	Total loss-absorbing capital.	**Bail-in**	Where losses are absorbed by those investing in a bank.
Volcker rule	The rule in the US enacted into Dodd-Frank to prevent banks from engaging in certain risky activities.	**Bailout**	Where losses are absorbed by persons outside a bank.
Stress testing	Routine tests on banks to highlight risk of failure.	**Hierarchy**	The order in which losses are taken by those investing in a bank.
Resolution	Resolution is the process by which the authorities can intervene to manage the failure of a firm in an orderly fashion.	**G-SIB/G-SIFI**	Global systemically important bank/global systemically important financial institution.
Vickers Commission	The report that presaged ring fencing in the UK.	**TBTF**	Too big to fail.
Liikanen report	The report that presaged some separation of activities in Europe.	**Top-down/single point of entry**	Resolution starting at bank holding company level.
Commercial banking	Deposit taking and lending.	**Bottom-up/multiple point of entry**	Resolution starting at a bank operating company level.
Investment banking	Securities trading and proprietary trading.	**MREL**	Minimum requirement for own funds and eligible liabilities.
Moral hazard	An example of agency risk where managers take excessive risks knowing that their business will be saved by authorities.	**Resolution weekend**	The time in which a bank will typically be resolved, allowing it to open for trading on the Monday.

significantly, but they do retain a chance to recover their money. The key point is that depositors do not lose under a bailout, but might under a bail-in.

Following the financial crisis, central banks established a process to enable financial firms to be easily wound down if necessary, ie in an orderly manner, with continuing provision of financial services, minimal impact on other firms and no public money involved.

The process of managing the failure of a financial firm is called resolution. In order to ensure that the principal functions of a bank can be maintained, a number of stabilisation tools have been identified, which can be applied as part of the resolution process:

- **Private-sector purchaser** – the transfer of all or part of a firm's business, which can include either its shares or its property, to a willing and appropriately authorised private-sector purchaser;
- **Bridge bank** – the transfer of all or part of a firm's business to a bank, which meets the relevant conditions for authorisation, pending a future sale or share issuance; and
- **Bail-in** – the claims of shareholders and creditors are written down and/or converted into equity to restore solvency (ie they bear the cost). The write-downs are in a strict 'waterfall' of priority.

A bail-in, (previously missing in many jurisdictions) is similar in effect to a corporate restructuring under Chapter 11 of the United States Bankruptcy Code. It is intended to restore solvency and avoid the disorder that would result from the bank suddenly ceasing to trade while it is reorganised without calling upon public finances.

The powers set out in the resolution regime are designed to ensure that shareholders and unsecured creditors meet the cost of firm failure and that the authorities have sufficient flexibility to effect an orderly resolution as quickly as is necessary.

But safeguards apply, which will ensure that no creditor is left worse off than they would have been had the whole firm been placed into insolvency and secured claims are protected.

Bail-in, like the other resolution tools, can only be used when it is necessary to do so in pursuit of clearly defined public interest objectives.

Two landmark resolutions in the UK include Northern Rock plc and Bradford & Bingley plc. There have been two resolutions since 2009 in the UK, namely, the Dunfermline Building Society on 30 March 2009, and the Southsea Mortgage and Investment Company Ltd, in June 2011.

What's this got to do with the treasurer?

The main effect on the treasurer is most likely around how amounts due from the bank may be affected. Time deposits, certificates of deposit and current balances may be bailed in, as may 'in the money' derivative positions. Don't expect that, because you have loans from the bank (bilateral or syndicated), the balances will be netted. You may lose money on a deposit and still have to repay the loan. If you enjoy letters of credit or guarantees from a bank in resolution, these may be at risk as well. If a bank under resolution has issued these on your behalf, they might need replacing.

Pooling, especially notional pooling where balances are offset, may also be affected. Pooling might in any case be more difficult under Basel III.

Conclusion

Bank resolution planning seeks to ensure that financial firms – whether large or small – can fail without causing disruption to payment systems and the normal support of trade without requiring a bail-in, thus exposing taxpayers to losses. Rather, the creditors of the failing banks should bear any losses, as they would do in insolvency, but without the financial instability and disruption to critical functions that the sudden insolvency of financial institution would otherwise cause.

By itself bail-in cannot guarantee that the resolution of a failed firm will be orderly. However, it can be used to stabilise the balance sheet of a failing firm until it can be restructured and, as such, is an essential component of a wider framework that, taken together, will allow authorities to intervene to manage the failure of large, complex firms in an orderly way. Treasurers must review their counterparty risk under these regimes.

Sarah Boyce is associate director, policy and technical; and Will Spinney is associate director of education at the ACT

1 projects.propublica.org/bailout/list
2 www.nao.org.uk/highlights/taxpayer-support-for-uk-banks-faqs

Optimal capital structures

FOR ANY COMPANY, THE OPTIMAL CAPITAL STRUCTURE IS A MOVING TARGET, SO REGULAR REVIEWS OF THE CAPITAL STRUCTURE ARE VITAL TO ENSURE THAT BUSINESSES ARE ABLE TO EFFICIENTLY DEPLOY THEIR STRATEGY AND GROW SUSTAINABLY, AS CHRISTIAN LEIBL AND YURI POLYAKOV EXPLAIN

Much has been written about the abundance of cash sitting on corporate balance sheets in recent years. But as the global economy continues to recover, the pressure on corporates to maintain precautionary liquidity is decreasing. In fact, with activist shareholders demanding that accumulated cash be put to use, the new challenge for treasurers is to ensure that the company's capital structure ensures sufficient flexibility for current (and expected future) economic conditions – rather than focusing on those experienced during previous financial crises.

Against this backdrop, now is an opportune time to reconsider what the optimal capital structure should be. Finding the right balance between cash, debt and equity funding is both an art and a science, since an optimal capital structure is a dynamic concept that shifts as the economic environment changes. Moreover, it is unique to each company – optimal means different things to different issuers, varying in line with specific operational or strategic contexts, as well as industry sector characteristics and management objectives.

As such, while textbooks might, from the outset, suggest defining a company's optimal capital structure in terms of the lowest weighted average cost of capital, it is actually far more practical to start by asking a simple question around objectives: what is it that you want to solve? Being realistic and open in answering this question – regardless of whether the company is looking to reduce its cost of capital or simply to maintain a conservative financial profile – is the only way to achieve a capital structure that is fit for purpose at that time.

IMAGE SOURCE

It is worth taking the time to consider what needs to be optimised in the company's existing capital structure, and what is sustainable about it

With the objectives identified, it is worth taking the time to carefully consider what needs to be optimised in the company's existing capital structure, and what is sustainable about it. During this process, it can be useful to keep in mind some guiding principles around what an optimal capital structure should deliver:

Optimal capital structure: guiding principles

1. **Efficiency.** Debt is always cheaper than equity and the capital structure should therefore include as much debt as the company is willing to afford, based on future cash flows. It is important to recognise here that affordability may be limited by industry sector. Companies in industries with stable cash flows, where the predictability of their cash generation is high, will inevitably be able to afford more than those in volatile industry sectors.
2. **Flexibility.** When thinking about the optimal

capital structure and affordability levels, it is vital to leave headroom to absorb the impact of any unwanted internal or external events – such as operational challenges or changes in interest rates – on cash flows and profit margins. This provides a safety barrier that is more efficient than holding a stockpile of cash.

3. **Liquidity.** Given the uncertain world in which treasurers operate, it is important to ensure that the company can tap different markets for liquidity as and when required. Having access to a broad funding toolkit will assist greatly in achieving the optimal capital structure and, indeed, for adjusting it over time. In addition, the broader the access to liquidity, the more routes that are available in the event a stress closes some routes to market.

With so many considerations to take into account, how then can a company put all of this into practice to implement an optimal capital structure?

Conducting a thorough review of the company's existing capital structure with a view to optimising it also means questioning the status quo. Is a large cash buffer really required any more? Is it in fact causing a drag on the efficiency of the capital structure?

Another area where corporates may want to do some soul-searching is credit ratings. For some companies, one of the main objectives of an optimal capital structure is to maintain a target credit rating, which grants them access to their optimal level of capital market liquidity. For other companies, though, the credit-rating target is more of a cultural or philosophical level that the company likes to maintain, rather than a funding strategy-driven necessity. While that is absolutely the company's prerogative, it is important to formally recognise this when setting the parameters of the optimal capital structure.

After all, credit ratings can open doors to investors' money. While investment-grade companies generally find good market access through the cycle, being sub-investment grade does not preclude an issuer from finding liquidity. The size of the debt financing that the company needs to raise and the market conditions at the time of issuance also play an important role. Over time, many companies have successfully tapped alternative funding sources, such as private placements, unrated bonds and loans, as well as hybrid instruments. Moreover, it is not only the financial profile or balance sheet structure of a particular company that determines the quality of its credit profile; it is the interplay between the industry dynamics, business model and balance sheet. So while credit ratings are important, they should not necessarily be perceived as the be-all and end-all.

A forward-looking approach

With so many considerations to take into account, how then can a company put all of this into practice to implement an optimal capital structure?

The answer: by taking a forward-looking view. The first step here is to build a base case for affordability, which means determining the expected future cash flows of the company. This should reflect the operating environment and business risks (including industry-specific characteristics, for example, change in competitive dynamics), as well as the macroeconomic environment. The treasurer's strategic business partners, such as relationship banks, will be able to assist in building this out.

From those future cash flows, it is then possible to determine how much debt the company could, in theory, afford and, in turn, how much equity should be in place.

Once the base case is determined, it is advisable to test its resilience using scenario analyses. This means stress-testing key cash-flow drivers, such as operating profits, interest rates, FX rates, working capital, capital investments and other growth initiatives – which can be impacted by business or financial market conditions. The key is to stress-test for both in a way that is consistent with the specific challenges faced by the business. Take a Europe-based airline business as an example. If there is a significant move in the £/$ exchange rate, then not only will the jet fuel price change, since commodities are priced in dollars, but customer demand characteristics are likely to change accordingly. This means that a single event in the FX market could have a double impact on the business.

Taking into account all the different risk factors that could affect the company's profit margins and cash flows in this way helps determine whether the proposed capital structure (resulting from the 'affordability test') is still functional and affordable. In other words, does the debt/equity mix need to provide adequate headroom – or to maximise efficiency?

Stress-testing also provides an opportunity to consider how the optimal capital structure will tally with the company's risk management strategy, and vice versa. How can the treasurer better manage any of the scenario stresses in order to increase cash-flow visibility and reduce cash-flow volatility, for example? Treasurers should also take into account how risk management techniques may impact the optimal capital structure.

Time to review

Once all of these considerations have been factored in, the treasurer can set about implementing the capital structure that has been determined as optimal. But part of taking a forward-looking view also means recognising that this is a moving concept – and, as such, it needs to be monitored, reviewed and adjusted from time to time. A simple rule of thumb here is that if the company's cash flows change by more than 10% from one year to the next, then it is time to revisit your capital structure and risk management strategy.

And whenever you undertake this review, regardless of the company's credit rating or industry sector, the guiding principles should always be: efficiency, flexibility and liquidity.


Christian Leibl (left) is head of capital structure advisory; and **Yuri Polyakov** (right) is head of financial risk advisory at Lloyds Banking Group

LLOYDS BANK

IAFEI News

January 14, 2016

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 was 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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EDITORIAL BOARD, OF THE IAFEI QUARTERLY

The IAFEI Board of Directors, in its meeting of October 13, 2015, in Milano, Italy, has installed the following Editorial Board for the IAFEI Quarterly:

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