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2016 October

LETTER OF THE CHAIRMAN

Dear Colleagues,

We have arrived at the vigil of the most important event of the IAFEI year. The 46th annual IAFEI World Congress will be held in Cape Town, South Africa, from the 9th to the 11th of November.

For the first time, our annual IAFEI congress takes place in Africa: no simple symbolic circumstance, but a true mark of the progress of that continent's economy has made on the road to a market economy with prospects for growth in GDP, consumer spending and living standards.

The title of our Congress "Africa driving global change" underlines these concepts, and promises a great opportunity for discussion, for new potential openings towards new markets, and for cultural and professional growth. It will also be an occasion to get to know the organizations of the CFOs operating in other African countries with the goal of getting them on board with IAFEI in the future.

I must take this occasion to sincerely thank SAIBA for the huge organizational effort made for this event, including a significant financial expense.
I am sure that the Cape Town event will be a resounding success!

Looking at the contemporary economic themes, we must mention a moment of uncertainty being felt globally, caused by the effect of political problems on manufacturing activities, international trade and currency valuations.
Most notably amongst these problems are the dramatic crisis in Syria, increasing difficulties building between Russia

and the western world, the first knock-on effects of Great Britain leaving the European Union, and the upcoming Presidential elections in the USA.

In a situation of turbulence at a global level, our CFOs must operate within the boundaries of their companies with professionality and prudence, taking careful stock of risk analyses on markets ever more globalized and interlinked.
Best of luck with your challenges, and we'll see each other in Cape Town !

Fausto Cosi
IAFEI Chairman

INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES

LETTER OF THE CHIEF EDITOR

Dear Financial Executive,

You receive the IAFEI Quarterly XXXIVth 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 is the Fourth One under the regime of the 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.

This issue, again, has more articles from inside IAFEI than before, an encouraging development. And once more the layout and the visual design have been further improved by the Italian IAFEI Member Institute ANDAF.

And this issue again has the more user friendly format, introduced in summer 2015. 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 all IAFEI member institutes, and to each of their individual 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
Chief Editor

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BRAZILIAN PUBLIC KEY INFRASTRUCTURE UNDER THE PERSPECTIVE OF COMPLIANCE IN THE CORPORATE ENVIRONMENT

RISK MANAGEMENT OPERATIONS, COMPLIANCE AND INFORMATION SAFETY ARE PART OF THE EVERYDAY LIFE OF FINANCE PROFESSIONALS, ESPECIALLY THE CFO. IN PARALLEL, IN BRAZIL AND WORLDWIDE, FRAUD SCANDALS ARE RAGING, INVOLVING THE FINANCIAL AREAS OF COMPANIES. IN THIS STUDY, WE SHOW HOW TECHNOLOGICAL ADVANCES, ESPECIALLY IN BRAZIL, MAY CONTRIBUTE TO A REDUCTION IN FRAUDS IN THE CORPORATE ENVIRONMENT. THE STUDY SHOWS THAT ACCESS TO THE ORGANIZATIONS' ELECTRONIC SYSTEMS THROUGH CRYPTOGRAPHIC IDENTIFICATION (ICP-BRAZIL STANDARD) MAKES THE POSSIBILITY OF FRAUDS IN CORPORATIONS HARDER, ALLOWING GUARANTEED AND UNDOUBTED RECOGNITION OF THE AUTHOR OF A DIGITAL MESSAGE OR TRANSACTION, GRANTING LEGAL RESPONSIBILITY.

by ISABELLA MIGLIORINI, Digital Certificate enrollment Agent and Administrator at Andato consultancy firm, Sao Paulo, Brazil
and LUIZ ROBERTO CALADO, Vice-President of IBEF, the Brazilian IAFEI Member Institute, and Partner at Andato consultancy firm

1. Introduction

The political and corporate panorama in Brazil in recent years has been awakening the constant coverage of fraud and corruption practices, showing the society's need to be aware and prepared. Thus, mechanisms that contribute to risk management and compliance are being sought by finance professionals.

Risk management is made with the adoption of better infrastructure practices, policies and methodologies (Funenseg, 2016), and companies are seeking new solutions to avoid activities that are damaging to their image and financial health.

It is worth to recall that Compliance reflects a set of

actions taken to comply with norms and regulations, be they domestic or international, also having prevention as one of its main functions - in an attempt to anticipate any kind of deviation or inadequacy and avoid frauds.

In this respect, digital certification (explained below) is born as a tool that may be combined with compliance and good management practices, considering offering the possible identification of group activities in digital means.

2. Theoretical Reference

Organizations need to make use of information, knowing how to identify which may be used most adequately. Information is an asset, adding value to the organization. It is a set of data classified and organized for organizations and their members to make use of. Information is actually a factor that may determine the life or death of activities in a business.

The challenge is controlling access to all information, mainly when dealing with banks and store chains, among others, so as to avoid assuming risks generated by undue access and use of information acquired or fraudulent changes in information. In table 1 the existing types may be identified:

Type	Definition	Examples
4.1 - Internal Fraud	Risk of losses due to activities like intentional frauds, subtraction of other people's property or infringement of rules, laws or internal policies, involving at least one company employee.	Extrapolation of responsibilities. Conflict of interest. Non-authorized access to information and technological resources. Undue or unauthorized publication of company information. Undue appropriation.
4.2 - External Fraud	Risk of loss due to activities promoted by people who do not belong to the organization, with the intention of fraud, undue appropriation of third party property and law infringement.	Embezzlement. Theft. Robbery. Fraudulent misrepresentation.

From: Manual de Controles Internos - Comissão Técnica Nacional de *Compliance* e Controles Internos,

Resulting from insertion of technology, be it in the execution of a bank payment on the internet or the automation of processes, this commodity has opened doors to frauds through digital media, also called virtual crime.

And, in this direction, one of alignment with compliance, digital signatures are born as an alternative mechanism for homologation of the most varied of operations, identifying people and processes executed in an inadequate way or in a way that is not failsafe.

2.1 Signatures and Digital Certificate

Very common in the non-Anglo-Saxon legal tradition, the signing of documents is a weak link in operations. In Brazil, which has a Latin tradition, real signatures are used to guarantee the certainty of their authenticity. In electronic documents, in turn, said signatures would be impossible, as they are intangible, needing technological creation and guaranteeing certainty of authorship. Faced with the difficulty of guaranteeing trustworthiness, digital signatures were developed.

ICP, the Brazilian acronym for PKI - Public Key Infrastructure refers to the official Brazilian Infrastructure, established in 2001. It is a hierarchic chain of confidence that makes possible the issuing of digital certificates for virtual identification of the citizen. It must be pointed out that the model adopted in Brazil was the single root certificate, with ITI – Instituto Nacional de Tecnologia da Informação (the National

Information Technology Institute), the organization responsible for performing the Root Certifying Authority (AC-Raiz) part, and also registration and cancellation of registries of other participants in the chain, supervising and auditing the processes (ITI, 2016).

Digital signatures are specific and codified data that accompany a specific coded "cyberdocument" in which it is possible to prove authorship of the message, as well as if it was modified after leaving the origin.

Thus, digital signatures comply with authenticity requirements, integrity and lack of repudiation in electronic media. That is, the author of an action knows that only his corresponding public key may decipher it. Thus, the address of said message is the identity of the issuer.

Digital certificates, therefore, arise with the function of guaranteeing that a specific public key belongs to a specific organization (user-machine interface). According to ITI (2016), digital certificate ICP-Brazil operates as a virtual identity that allows for safe and undoubted identification of the author of a message or transaction in electronic media, like the web.

This electronic document is generated and signed by a trustworthy third party, i.e., a Certifying Authority (AC) which, following rules established by the ICP-Brasil Managing Committee, connects an organization (person, process, civil servant) to a set of cryptographic keys. Certificates contain data on the owner, in accordance with the Safety Policy of each Certifying Authority, and are for personal and untransferrable use (ITI, 2016).

The infrastructure of the digital certification, in line with the standards, standardization and regulations of ICP-Brazil guarantee the authenticity and integrity of digital documents digitally signed.

The applicability of digital certificates standard ICP-Brazil was identified in the most varied of scopes in terms of organizations' electronic systems, be it for use in access to the company's internal systems, for adaptation of software used by the financial area, or for homologation of access to operations to be performed in the network by this area.

When dealing with actions considered fraudulent in the corporate environment, it is necessary to understand that the option for objective responsibility of companies consists in considerable legal news in the domestic conjecture, to considerably alter relations between the companies and staff and collaborators. As the CFO has the responsibility to produce, transmit and disseminate financial data recorded in digital electronic media, the digital signature provides the security needed to meet the interests, fulfill rights and duties, which require verification of data and information electronically.

Organizations must therefore consider all dishonest or guilty activities their responsibility, no matter if it is known or not, as well as implementing Anticorruption Laws as the base for penalization, therefore, expecting the mechanism presented in this work to contribute to these purposes.

3. Final considerations

With regard to the alignment of activities promoted by organizations through their compliance agents, digital signatures have been identified as a levelling mechanism for said practice, identifying authors and, consequently, processes executed in inadequate or incorrect manner, judicially recognizing said activities.

Certification is seen as a way to facilitate and ensure in electronic form the principles of authenticity, integrity and confidentiality of documents. Countries such as Germany, Argentina, Spain and Brazil regulated digital certification in order to ensure secure electronic transactions by means of certificates and digital signatures.

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BREXIT: CONSEQUENCES

By HELMUT SCHNABEL, chairman Association of Chief Financial Officers Germany, the German IAFEI Member Institute, presentation given at the board of directors meeting of IGTA, International Group of Treasury Associations, in Dublin, Ireland, September 17, 2016

ECONOMIC AND BUSINESS CONSEQUENCES - POLITICAL CONSEQUENCES - CULTURAL CONSEQUENCES

Preface: Some economic and other facts, to be borne in mind:

The 28 member countries European Union, including Great Britain (Britain) has a population of 508 million people. Britain with a population of 65 million, or 13 % of this, is the third largest member country in terms of population (Germany with 81 million inhabitants being the largest, France with 66 million inhabitants being the second largest).

The 28 member countries European Union has a GDP 2015 of 14.272 billion €. Of this, Britain with a GDP pf 2.569 billion € represents the second largest economy of the EU (Germany with 3.026 billion € being the largest economy, France with 2.184 being the third largest, Italy with 1.636 billion € being the fourth largest.).
In world and GDP terms, Britain is the fifth largest economy (behind USA, China, Japan, Germany).

Trade 2015 between the 27 member countries of the European Union and Britain is huge: 301 billion € imports from the 27 EU member countries (= 53 % of

all British imports). 184 billion € exports to the 27 EU member countries (= 44 % of all British exports).

For the three other largest economies of the EU (Germany, France, Italy) Britain is for each one the third largest export market (7,4 % of German exports; 7,0 % of French exports; 5,4% of Italian exports).

Thus, the 27 EU member countries have a trade surplus of 117 billion € with Britain (of which 42 billion € is German surplus with Britain.). The 28 member countries European Union has a budget 2015 of 145 billion €.

Over 80 % of this is financed by cash contributions of the member states as a % of their GDP.
Three quarters of the total budget are paid back to the member countries as agriculture subsidies and other structural reform investment subsidies.

The largest net payment Payer countries and the largest net payment Receiver countries of the European Union are the following:
The largest net payment Payer countries:
in million €, 2015

Germany	14.307
Britain	11.521 *)
France	5.523
Netherlands	3.695
Italy	2.600
Sweden	2.200
Belgium	1.388
Danmark	790
Luxemburg	94

The largest net payment Receiver countries:
in million €, 2015

Poland	9.483
Cech Republic	5.699
Roumania	5.154
Greece	4.934
Hungary	4.637
Bulgaria	2.279
Latvia	759

*) The number for Britain in 2014 was around 4.900 million €.
The 11.521 € for 2015 are exceptionally high, due to a diversity of special effects, dating back several years and leading finally to cash payments in 2015.
Both numbers for Britain for 2014 and 2015 are lower, annually, by 6.100 million €, due to the annual British Rebate, which then Prime Minister Margaret Thatcher negotiated, as a compromise settlement, with the European Union (Original request "We want our money back!").

Brexit: Consequences - Economic and Business
Immediate consequence, is uncertainty:
- about how quickly or how slowly the Brexit will be put into practice. There is daily speculation about this in the media. The expectation now is, that the British government will formally declare to leave the European Union during the course of 2017, and from that date on as per article 50 of the EU the maximum 2 year negotiation period with the European Union starts, about how the terms of the separation are going to be. Should no agreement be reached, then the separation as per the EU articles takes place without an agreement.
- about which institutional form the Brexit will take
- about how friendly or unfriendly the separation process will be
- about how the future co-existence of the now smaller European Union and Britain will look like..

Is also confidence that there will be continued trade between the now smaller European Union and Britain, though possibly at a smaller scale, that there will be continued direct investment between the 2 areas, though possibly on a smaller scale.

Is also the reality that the now smaller European Union and the separated Britain will each be a smaller economic power in the world context than when acting together as one economic union, and thus each of the 2 will lose some of the attractiveness for attracting foreign direct investment and trade from outside Europe, than before.

In summary, the immediate consequences are a mixed bag of effects.
There is widespread consensus, that the Brexit, economically, is neither a catastrophy nor an event of happiness for all people impacted by it on both sides.
Economic consequences will be many and diverse ones.
Which model of co – existence between the now smaller European Union and Britain will evolve?
There are 2 precedence cases to be observed for comparison:
One: Norway
Two: Switzerland

To Norway:
Norway, together with Iceland, Liechtenstein and Switzerland, is part of EFTA, the European Free Trade Association, established in 1960.
Starting 1994, the 3 EFTA Member States Norway,

Iceland and Liechtenstein, together with the European Union, formed EEA, the European Economic Area.
Switzerland stays out of the European Economic Area.
Today the European Economic Area encompasses the 28 EU member States plus the 3 countries Norway, Iceland and Liechtenstein.

The EEA Treaty extends the 4 basic freedoms of the European Community to all EEA members:
Freedom of movement of services,
Freedom of movement of capital,
Freedom of movement of goods
Freedom of movement of workers

The European Economic Area is an intensified free trade zone. There are only restrictions as to agricultural goods. The laws within the EEA are to be interpreted in conformity with the EU legal regulations.
Practically speaking, Norway, Iceland and Liechtenstein have full access and are part of the Internal Market of the EU. But this is not for free:
Norway, Iceland and Liechtenstein contribute annually money to the EU – Budget. For the 8 years of 2014 to 2021, an amount of 2.8 bill €. The bulk of it, 2,7 bill €, is paid by Norway.

By contrast , the annual net financial contribution by Britain to the EU, after deducting payments into Britain from the many EU incentivation programs, are at around 4.9 billion € in 2014. Of this, Britain would have to pay 83 % under the Norway model, as per a study of the British House of Commons of 2013.

However, an essential of the Brexit decision is, that Britain wants to stay out of the European Union´s free movement of workers regime, that it further wants to determine alone its immigration policy (whether it wants immigration at all, and if so, at which terms), and that it does not want any more to make payments to the EU.
Such a British position is presently being called " hard Brexit ". So it is therefore doubtful, whether the Norway model can be watered down to comply with the British wishes.

To Switzerland:
A neutral country since centuries. The most competitive country in the world, as per the Global Competitive Report 2016 – 2017, of the World Economic Forum. A country of great economic wealth, of freedom, of the rule of the law, of order, of direct democracy unmatched by most other democracies in the world. All of this achieved without being a member of the European Union.

Switzerland, did not join the Norway-model, by way of a referendum in 1992, and did not become a member of the European Economic Area and not of the European Union.
Until 1999, Switzerland has negotiated 7 sectorial treaties with the European Union on:
-the freedom of movement of persons and workers
-the removal of technical trade tariffs
-the public government procurement purchasing schemes
-research and technical cooperation
-trade with agricultural products
-land traffic
-air traffic
This first package of treaties was completed by a second round of treaties until 2004, relating to the food industry, tourism, taxing of interest, as well as political areas such as security, fight against fraud, asylum, environment and culture. But there exists no treaty about financial services, which is a fundamental business field of Switzerland. And which it likewise is also for Britain.
And Switzerland has no vote or veto over the creation of EU rules and regulations.

Recently, all Swiss Treaties with the EU have a new question mark, as the Swiss by another referendum have decided to curtail mass immigration, which must be put in place by February 2017, and which may also have an impact on the present free movement of workers between Switzerland and the EU. Switzerland wishes to find a peaceful negotiation solution with the EU. Any offer by the EU to Switzerland of compromise as to the free movement of workers with the EU, if any by the EU, will then be called for by Britain as well.
Also Switzerland is paying for its access to the internal market of the EU. But because of the complexity of the treaties, the total number so far is not made known. Given that Switzerland
is a not far from twice as large economy as Norway, it is fair to assume that the payments to the EU are proportionately larger as well.

An imaginable final outcome
Given the great economic and business interdependence of Britain and the other 27 member countries of the European Union, it would not be surprising, and is to be expected, that, in view of what is at stake, common sense will prevail, and a fair compromise and co-habitation of the two sides will be negotiated at the end of a tedious and burdensome negotiation process. This in spite of all the noise which orthodox politicians will continue to make on both sides.
Should this then so happen, then one shall speak of a " soft Brexit ".

Other major economic consequences to be expected and considered:
Britain, as a location for European Union Institutions, will discontinue to be so.
As a consequence, the seat of EBA, the European Banking Authority, will have to be moved to another member country of the European Union.
Another key area, is the future role of the British London financial market and location. As complex, as this subject is, the direction is clear and twofold: London will remain a leading financial market, servicing the world. But the role of the London Financial Market location as it relates to the European Union, will diminish. And other sites within the European Union will be the beneficiaries, among them Amsterdam, Dublin, Paris, Luxemburg, and Frankfurt on Main.
In this context, it remains to be seen, whether the European Union´s scheme of the "single passport", also called "European passport" in the field of regulation of the services of banks and financial conglomerates will be maintained for Britain or not. Credit institutions with a licence in any European Union country and European Economic Area (EEA) country, are in principle permitted to carry on their business in other member states, too, without further authorisation requirements in such countries. Cross-border business may be carried on either through a local branch ("freedom of establishment") or by means of free movement of services ("freedom to provide")
Many non-European banks have their European subsidiary headquarters in Britain and based on the single passport operate branches or direct to the market activities in other European Member States. If the single passport status is not maintained for Britain, such banks, and also British banks, when wishing to do banking business in the remaining European Union, have to go there with an European banking subsidiary headquarter and have to go through the local approval process for such banking subsidiary.
Also, the merger between the London Stock Exchange and the Frankfurt Stock Exchange will probably be halted by the sovereign regulators. Everything else would be a surprise, notwithstanding the noise in the media.

Last, but not least: Should the significant net Payer payments by Britain to the European Union be stopped completely, and should the remaining 27 member countries of the European Union not make up for this loss of net payments, then in the worst case such loss of net payments will be to the detriment of the net payment Receiver countries, i. e. the economically weaker countries of the European Union. They will then, sadly, receive less financial support from the European Union, making such Union for them less attractive.

Brexit: Consequences -Political Consequences.
They are many:
The immediate question is: What went wrong, that the second largest economy of the European Union decided, to get out of it completely?
Since the Brexit vote, there is daily discussion on this by almost all famous politicians, economists, business people, philosophers, etc., you name it.
One school of thought, which is also powerful in Germany, calls now for more Europe, for more European integration, for moving more sovereign power from the nation states to
Brussels, to the degree of creating an European Finance Minister with full control over national budgets, and for creating a European President directly elected by the people, and other proposals making the European Union more like a uniform centralized state throughout the continent.

Chances for this to happen have decreased dramatically in recent years. The single national states seem less than before inclined to give away more parts of their sovereignty than before.

Another school of thought calls for less Europe, to the degree of requests in more single national states to opt for leaving the EU, or at least the Euro, by way of a referendum. This is a trend of thought. Europe is far from where this trend is pointing to. But here are some supporting signs for this trend:
There is the rise of national so called populist parties in several European countries, calling for a smaller role of the European Union or even an exit from the European Union, or at least from the Euro, by way of a referendum. The fact is, there are public requests for such referendums now, more than before.
The biggest such movement is the rise of the Front National in France, which as per the present polls is the biggest party in France, though it is said to be far from getting a French majority vote.
There are similar movements in Finland, Denmark, Sweden, Netherlands, Italy, lately also Germany, and others.
Within Britain, Scotland and Northern Ireland voted against the Brexit. It remains to be seen, whether Scotland will again request a referendum about leaving the United Kingdom and thereby paving the way for remaining in the European Union.
In the past, Sweden had a referendum on staying out of the Euro and on maintaining the Swedish Krona. Denmark got the contractual guaranty from the EU, that it does not have to introduce the Euro, even if it would

qualify for it.

There is the third school of thought, calling for a more realistic and less visionary and less idealistic role of co – habitation of the European Union with the national member States. The principle of subsidiarity should be emphasised more than before. This implies: If there are doubts, whether a matter should be regulated centrally by Brussels, or in a decentralized way by the national states, then the latter should be applied, and not the first. The bottom line would be a more humble Brussels, and a less dictatorial Brussels.
The third school of thought also calls, for that the member states are abiding to the treaties and contracts they have signed before, and that they do not disregard and breach the treaties and contracts again and again, which they have signed before.
One example for this being, in the context with the creation of the Euro, the pact for stability and growth, and the Maastricht criteria, which to repeatedly break is commonplace by the European member states, which undermines the credibility of the European Union as a whole. Over 150 times the stability and growth pact has been violated. And the punishments, put in place by such pact for cases of breaching it, have consistently not been applied, with one only exemption: Hungary.

As an example, since 2009 France is having an excessive annual government deficit, exceeding the 3 % of GDP Maastricht criteria. Again and again, sanctions mandated by the treaties, have not been applied by the European Union. The reason for this, lately been given by European Union Commission President Juncker, was: Quote: Because it is France. Unquote.

Regaining credibility for its treaties, regulations, promises, is key for the European Union, beyond any consequences of the Brexit.

As to NATO, the North Atlantic Treaty Organisation, this will not be impacted by the Brexit. Britain and the other European member states of NATO will all remain members of NATO. For all of them NATO remains the backbone of their security. No dispute on this is being voiced, fortunately and reasonably.

Brexit: Cultural Consequences
In cultural terms Britain is and remains a part of the European culture.

Such culture encompassing: commitment to peace, democracy, freedom, liberalism, christianity, freedom for other religions, human rights, no death penalty, rule of the law, protection of property, freedom of the press, freedom of opinion and speech, freedom of travel, division of public power into executive power, legislative power, judicative power, to name a list of many but not all important ones.

The European politicians, as well as national politicians keep telling their citizens, that the European Union is more than an economic Union, more than a common internal market, more than the uniform currency, the Euro, and more than a Union, which has maintained peace among its members, since the inception of the Union after World War II.

They keep saying, that The European Union is, first and foremost, a Union of Common Values.

I have no doubt, that after the Brexit, Britain will continue to share such Common Values with the remainder of the European Union member countries sharing them as well.

But significant, severe exceptions have become visible:
The most pressing exception presently is the subject of letting refugees, and/ or non refugee migration come into the Member States of the European Union: Over a million refugees have streamed into Europe in the last 12 months. Only 6 countries have taken refugees, the other 22 Member Countries of the European Union have taken none. This is not a Union of Common Values.

The other big exception presently is the subject of how to run a free market economy successfully in times of globalization. The Ones are calling for structural reforms of the national economies including labour and social reforms, and containing excessive government debt and excessive non government debt. The Others are blaming this as being painful austerity and call, in spite of many member states being over-indebted, for massive public expansion programs being even more financed by government debt and being printing press financed. This is not a Union of Common Values.

TALENTS IN SHARED SERVICES

MISCONCEPTIONS ABOUT TALENT IN THE SHARED SERVICES INDUSTRY AND WHAT THEY TEACH US

By ANNE RAPP, Executive Coach and Consult at Parena Consulting, Paris, France, October 2, 2016 article provided by DFCG, the FrenchIAFEI Member Institute

Most of you, as Finance Managers, Controllers or Business leaders know that Finance and Accounting, as a function, constantly faces the challenge of flexibility and competitiveness. Most of you have worked with, or will work with, either a shared service center or an outsourcing provider.

What I would like to share with you are some misconceptions about talent in the shared service industry and how I believe people with your responsibilities may engage in shared service centers so that the expected benefits of such transformation do shape into concrete results.

Two misconceptions about talent in the shared service industry that can often prevent business leaders from reaping full benefits of shared service projects: These misconceptions and thoughts about talent management came to my attention while working closely with multiple clients on Finance Transformations projects.

Misconception 1: There is no need for talent in the shared service center industry.

When I took my first job in the outsourcing industry, one of my mentors, a senior finance manager from GE, predicted to me that this would be a wrong move for my career. Reality is that this industry is at the heart of many business transformations. This industry has been developing, growing and adapting at a very high speed and with constant higher demand in terms of customer expectations. This has only been made possible through attracting and retaining talented individuals.

At the end of 2012, the ACCA (The Association of Chartered Certified Accountants) undertook a global survey about « talent practices in finance functions with shared service operations ». On one hand the majority of the respondents recognized the critical importance of talent management strategies to be effective in a finance model with shared services. On the other hand, a surprising 72% of the same respondents declared that either their finance functions did not implement talent management programs or that they were unaware of such programs.

If you want to set up an internal shared service center do make sure that you put talented people to implement it and to run it!

Misconception 2: The shared service industry does not develop leaders.

Some of the pivotal roles within a service center environment are great opportunities for leadership growth. They provide the field for developing numerous skills in a challenging and demanding environment. An Operational Manager (in charge of managing a team leading a process) or a Transition leader (in charge of transitioning a process from an environment to another) will have a vast range of development opportunities:

- The need to wear multiple hats. They learn on the ground the art of being both strong team leaders and to manage customers' expectations, relationship and experience. They are often faced with situations that required them to be agile, open, great listeners and innovators. More often than not they are dealing with multiple customers (internal or external).
- A fast moving environment for accelerated learning. Ranging from mentoring programs to learning centers, or to consulting assignment abroad, they do have the opportunity, for the most ambitious, to expand their knowledge and competencies at an incredible speed.
- The necessity to be an expert. They must know and understand end to end processes. They are often part not only of the day to day operations but they often contribute to the team designing the solution that was put in place or reengineering processes.
- A requirement to constantly evolve. New skills are being developed as part of the curricula such as Process Excellence, Controls, Analytics and Automation. In the next few years, automation or artificial intelligence will become a game changer for outsourcing providers. The industry and the people composing it will need to adapt and to perform in an environment more and more demanding and completely different.
- A requisite for international exposure. Many jobs in a shared service center or in the outsourcing industry, de facto, include an important international component and the capacity to work in a multi-cultural environment, in a global and virtual setting.

Shared Service Centers are a great field for developing leaders. Either within the 'outsourcing' industry players or within Multinational shared service centers. They are often an important part of the strategy of a business, directly connected with operations, client care, and functional support.

So what does this mean for leaders engaged or willing to engage in a Finance Transformation project with a Shared Service Center (or outsourcing partner).

I think that those two misconceptions, these beliefs

(conscious or unconscious), are often preventing some organizations and some leaders to really reach the full potential of their environments.

Talent management is a big part of what determines the success of a transformation and unfortunately it is rarely part of the business case and of the business transformations road map.

Talent management in a shared service center is one of the biggest items to be considered as part of change management because it is directly linked to two pivotal elements of operations: stability and adaptability. Businesses have to plan and to invest in leadership development, in communication, in defining career paths. This is not to be underestimated. All those investments will shape the culture you want to create. This way of managing talent should be a « way of working », embedded in the organization.

Talent management requires planning, development opportunities, challenges and strategic placement. In this domain Shared Service Centers are not different than many industries. While the subject of governance is often looked at in great detail in the context of contractual agreement or Statement of Work, the subject of talent management, career path, and new competencies are very often not scoped or are underestimated when you are developing an internal shared service center or planning to contract with an outsourcing provider.

You, as business and finance leaders have a huge role to play. I remember some of my clients coming and visiting the shared service center, spending time with people, discussing one on one career opportunities, aspirations and ambitions. I remember some inviting the teams to an important business review in the headquarter, asking for their perspective, fostering an environment of trust and transparency. And I remember others not investing the time and interest to those type of questions. I let you guess which one were successful and which one were not.

What made a shared service center successful today will not (be enough to) make it successful tomorrow.

Twenty years ago, when I worked on my first finance transformation project, it was all about technology, optimization and simplification. In a way things have not changed that much in nature. We still speak about technology, optimization and simplification. The key differences I see are (1) an acceleration of technological evolution and (2) and increased level of complexity emerging from the processes a Shared Service Center can offer.

- As finance leaders you will have to manage and challenge Shared Service Center to the next level. Leadership traits such as communication, connection, collaboration and creativity will be more and more essential.

- You will need to take into consideration the ability for Shared Service Centers to develop processes that encompass the characteristics of a VUCA world (B. Johansen defines VUCA: Volatility - Uncertainty - Complexity - Ambiguity). An Accounts Payable Process done in a shared service center today will leverage technology to become flawless tomorrow. The needs in term of skills will be around tech people who will not only maintain a system or support a system but who will constantly need to understand how to re-invent it, who will be able to manage the digitization and integrate it in applications that will come to market faster.

- With this comes also for you the possibility to challenge shared service center to include in their scope more and more complex solutions or to participate more actively in the solving of complex process issues you can have 'in house'. Many outsourcing providers have great reengineering consultancy services.

- Lastly, managing more complex processes means that your ability to create / foster an environment where issues can be discussed openly will be essential. It is not a question of 'the Shared Service Center' versus 'the Customer Organization'. In that matter I believe that the quality of the output you get from such organization is proportionate to the ability to foster trust, transparency and to solve openly complex and sensitive issues.

The bridge between businesses and their shared service centers (off shore or outsourced) in term of talent management and « ways of working » must be nurtured. It is crucial for the success of Business Transformation and for the ability for the industry to adapt to new challenges ahead.

SENIOR LOANS - THE BETTER HIGH YIELD BONDS

By SEBASTIAN SCHU, Head of Asset Management Sales Germany & Austria, Lyxor Asset Management Germany, Sub-Group of Société Générale Group, Paris, France, from Börsen-Zeitung, Frankfurt am Main, Germany, August 18, 2016,, article provided by the German IAFEI Member Institute GEFIU, Association of Chief Financial Officers Germany

In spite of the many incentives by the ECB, European Central Bank, the loans given out by the European banks are not materially increasing; since the middle of 2014, the total volume is more or less unchanged.
The indebtedness of the corporations, however, is reaching one record after another. The capital gap is ever more filled out by the "non-banks".

The market share of insurance companies, pension insurance companies and other capital raising institutions grows continually.
The political support for the "disintermediation" - key notion " capital market union" - allows to expect, that this share will continue to increase further.

The classical way of the investors into the debt capital of corporations is the strongly regulated and standardized market for corporate bonds. Still relatively unknown as asset class are in Europe the so-called "Senior Loans": Large loans, which are given out by banks to corporations, mostly without an investment grade rating, and which are subsequently syndicated.

Out of the offers out of this market segment, specialized asset managers like Lyxor are creating funds, and provide to their customers access to this interesting asset segment. Diversified vehicles with broadly syndicated European loans encompass

mechanisms, which make this typically illiquid segment of Private Debt interesting for investors with higher requirements as to the availability of capital.

Comparison with High Yields

Senior Loans, as to their risk and return profile, are often compared to High Yield Bonds. In the USA, in the meantime, also the order of size of the two markets is now comparable: with a volume of almost 1 trillion US $ (as per data of Loan Syndications Trading Association), the Senior Loan Market has reached the size of the High Yield Bond Market. In Europe, by contrast, in 2014 around 200 corporations have issued syndicated loans below investment grade with a volume of almost 80 billion €. And here the issuers came especially from the sectors food, drinks, and health, as well - in geographical terms - from Great Britain, France, Germany, the Netherlands.

This is an interesting aspect from the point of view of diversification; by comparison with a conventional index for corporate bonds, this distribution appears to be advantageous, as well as regards the countries, as well as regards the industries. In the current year, though, the volume of Senior Loans decreased, but the volume of loans securitized for institutional investors as a total increased in the same period by 41 %, as per S&P.

For institutional investors, who are especially concerned with security, the Senior Loans are offering a structural advantage compared with High Yield Bonds: The obligations of the issuer as per interest and repayment are securitized as a rule by other corporate assets and therefore have a better position in the capital structure of the corporation. Typical contract covenants regulate for instance the preferred position before the payout of dividends, the repayment of equity, of the interest payment to the other bond holders. With this Senior Loans are better secured than subordinated bonds or other equity-similar instruments, and they are in a preferred position in the case of insolvency.

This is also the reason for that they have shown a considerable resistance capability against the lately strong fluctuations of all other risk-assets. At the peak of the market weakness in February of this year, the Leveraged Loans (as measured by the J.P. Morgan Leveraged Loan Index) have lost 75 basis points. High Yield Bonds, however, showed a loss of 350 basis points as measured by the BAML European Currency High Yield Constrained Index. In the first two days after the Brexit-Referendum the Leveraged Loans have lost 78 basis points, und thus less than the loss of 185 basis points for the High Yield Bonds.

A similar result could be observed at the US High Yield Bond Market and is being confirmed by the long term observation as well. Whereas the annualized volatility of the Credit Suisse Leveraged Loan Index between January 2009 and October 2015 was a bit over 5 %, the Credit Suisse High Yield Index has a volatility of short of 10 % annually.

Senior Loans achieve average returns of presently 5,8 % (J.P. Morgan Leveraged Loan Index), at the same level with High Yield Bond average returns of presently around 5,8 % (J.P. Morgan European High Yield Index). Thanks to lower volatility, higher recovery rates, and lower duration risk, they offer, however, a better risk-return profile. The default risk in Europe has hardly increased.

The reasons which are seen in the USA for an increasing number of corporation insolvencie - the low oil price and the interest rate raising scheme initiated by the Fed - we do not see working in Europe. To this adds, the raw material sector in the global credit market only accounts for 5 %, which should make the Senior Loan market from a diversification point of view more robust than the High Yield sector.

What also in Europe could lead to higher default rates, would be a global recession or a significant widening of the spreads for corporations below investment grade, which would make a substitution of existing financings more difficult. Also these risks we consider as being small.

But the default of a debtor is the main risk of a Senior Loan Fund. Therefore, an investor is well advised, to pay special attention in the selection process, that the asset manager has sufficient restructuring know how, so that he can make better use of the possibilities, which offers to him a better position in the capital structure of the corporation.

The smarter analysts and lawyers, in the case of bankruptcy, typically achieve better recovery rates. The recovery rate of Senior Loans was 76 % as a long term average, according to Société Générale Research, holders of High Yield Bonds in the case of bankruptcy recover on average 85 % of their investment. In addition, the default rate at High Yield Bonds has been with 10,54 significantly higher than at Senior Loans with 5,8%.

Structural Advantages

Adding to this are further structural advantages: the variable interest rate, and the protection from negative interest rates. In most loan contracts the level of the coupon is fixed as a spread over Libor or Euribor and produces a stable interest payment - independently from the present interest rate level. Other than with regular Corporate or High Yield Bonds, they are not losing value, when interest rates go up, and thus have hardly a duration risk. How strongly this advantage did materialize, show the data about 2013, when the Fed announced its 2"apering": the bond markets corrected by around 5 %, whereas the loan market only for a short while around 1,5 % - and also this only because the stress at the bond markets permitted arbitrage.

In a time, where more than half of all bonds issued in Europe are trading in negative territory and the key interest rate of the European Central Bank is at zero, another feature is getting especial significance. In most loan agreements, there is a clause, which when calculating the coupon, the floor of the reference rate Euribor is set at zero. This implies, that even at the presently negative Euribor a real spread of 4,5 to 5,0 % is being maintained.

In the context of the portfolio, this means, that the volatility is lower, and that the correlation to other Fixed Income Assets is low. Regular, hardly fluctuation returns are especially attractive for institutional investors with fixed long term liabilities. These also especially regulated capital raising institutions can raise the return of their solvency capital by shifting from Corporates to Senior Loans.

SOURCE: BÖRSEN-ZEITUNG, FRANKFURT AM MAIN, GERMANY, AUGUST 18, 2016.
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A VISION OF MEXICO

THIS ARTICLE IS INTENDED TO BE READ BY GLOBAL INVESTORS, CEOS, CFOS AND OTHER FINANCIAL DECISION MAKERS, AND IS FROM THE PERSPECTIVE OF A MEXICAN NATIONAL WHO HAS HAD THE OPPORTUNITY TO LIVE ABROAD

By JOSE JAIME DIAZ GONZALEZ DE LA CAMPA, Member of National Technical Committee of Integral Risk Administration of IMEF, the Mexican IAFEI Member Institute

I am among the very few Mexicans who have an advanced education, career and life experiences in other countries, and have come back to my native land. But since I work for a multinational company, I now consider myself more of a global citizen. Many people I know have asked why I decided to come back to Mexico after living around the world for many years. My answer is that we live in a unique country! We don't realize how marvelous Mexico is or appreciate everything about it until we are a part of it.

Mexico at a glance

Mexico is the 15th largest economy in the world and fourth biggest in the Americas, just behind the United States, Brazil and Canada. GDP per capita, on the other hand, is 65th in the world. So looking on the bright side, we have huge upside for growth. As a country, we need to find our voice and tell the world what we do, and what we are capable of achieving.

Mexico is strategically located, benefitting from 1,250 shared miles of border with the U.S. and access to two oceans. We also hold 12 free trade agreements with 46 countries. From a logistics standpoint, every company that wants to sell to the biggest markets in the world, should come to Mexico.

Right above Central America, our country has a variety of climates and altitudes, which provide the right conditions for growing almost any agricultural product. Our land is also very rich in minerals, helping to raise poultry, cattle, hogs, and other proteins that provide the world with high-quality meat products.

Mexico is the 12th largest producer of commodities globally, 13th in agriculture, 11th in cattle growing, and 17th in seafood. It exports about $60 billion of agro food products annually, mainly to the U.S.A. We are the No. 1 avocado producer in the world, and among the top green pepper, lime and strawberry growers. Further, innovation continues to spur production growth. We are also one of the five biggest car manufacturers in the world.

Mexico also enjoys cultural diversity. While Spanish is the main language, there are 68 other distinct, indigenous languages spoken, and our history goes back to before the 14th century. We have developed mixed traditions from pre-Hispanic and Spanish origins.

Our peso is the fifth most traded currency on the Chicago Mercantile Exchange, just after the U.K.'s pound, the euro, the Japanese yen and the Australian dollar. So with all of this, Mexico is beginning to establish itself as an economic powerhouse.

Yet, while Mexico has improved conditions for opening and operating new businesses, there is significant room for change. Eighty percent of local GDP is generated by companies with less than five employees and two thirds of all startups fail within three years. Entrepreneurs simply lack the resources to develop their products and services.

Additionally, there is an "outside-the-system" economy in Mexico that diverts significant profits to parties not subject to taxes, weakening the country's financial position. The challenge is to register and tax non-paying entities to improve the nation's infrastructure and services. Mexico is also vulnerable to foreign exchange rate fluctuations.

Then how can we get more international companies to invest in Mexico?

Despite these challenges, we can compete for capital and give long-term certainty to investors – but Mexico must do better leveraging its strategic location; "Outside-the-system" players need to pay their fair share; and exports must increase. Of course it's easier said than done, but everything is possible by focusing on the right goals. And as Mexico's economic momentum builds, so will its prosperity.

ON FINANCIAL SECRECY & LEAKS

By CONCHITA L. MANABAT, President of the Development Center for Finance and a Trustee of the FINEX Development & Research Foundation. A past Chair of International Association of Financial Executives Institutes (IAFEI), she now serves as the Chairperson of the Advisory Council of the said organization. She is also a member of the Advisory Group of the International Ethics Standards Board for Accountants. Article as of July 2016

"If governments did not mislead their citizens so often, there would be less need for secrecy, and if leaders knew they could not rely on keeping the public in the dark about what they are doing, they would have a powerful incentive to behave better."
Peter Singer

It is only the fifth month of the year yet several financial scandals have hugged the headlines of broadsheets in the Philippines.

In February, hackers successfully moved US $81 million from the Bangladeshi's account with the Federal Reserve Bank to a Philippine universal bank. The funds could have finally found their way to casinos and elsewhere. The matter is still under investigation by the Society for Worldwide Interbank Financial Telecommunication (SWIFT), a supersecure system that banks use to authorize payments from one account to another. (One analyst describes SWIFT as the Rolls-Royce of payments networks.) Also probing on the heist are the Philippine senate and the Bangladeshi government.

Early April 2016, the burning issue on business news, print and electronic, was the 11.5 million documents leaked from a Panama-based law firm, Mossack Fonseca, on the "secret or confidential" offshore financial transactions of world leaders, celebrities, and sports stars. Some of the who's who and the elite of the world were named "beneficiaries" or "players". The documents were supposed to have

been obtained from anonymous source by a German daily and shared with more than 100 media groups by the International Consortium of Investigative Journalists (ICIJ).

Last April, it was reported that the Qatar National Bank's (QNB) computer systems were hacked. The QNB released a statement thru its website that the cyber attack would have ”no financial impact” on its customers but there was admission that for the first time, its clients were targeted. The “data leak” may potentially expose the names, passwords, mobile phone numbers, credit card numbers, and international bank transactions of tens of thousands of customers.

Two common threads weave through the three major financial “episodes” - significant/valuable assets & information and the secrecy behind them. The adverse impacts of the leaks of these secret/confidential financial transactions & information have been the continuing concerns of sovereigns and regulators.

On April 22, the European Union Finance Ministers (ECOFIN) Council members agreed to undertake a pilot project for the automatic exchange of information on the “ultimate beneficial owners” following the letter by the so-called G5 (the UK, Germany, Spain, France and Italy) manifesting the group's intent to pursue such pilot project. The outcome of this pilot project may pave the way for the development of “a global standard and interlinked registries” containing full beneficial ownership information.

The Organization for Economic Co-operation & Development (OECD) and the Financial Action Task Force (FATF) will be the prime-movers behind this development.

European Commissioner Dombrovskis cited that the Commission will follow-up on the mandate “to explore ways to introduce disincentives for those who give advice in tax evasion planning and elaborate tax evasion schemes”. The European Commission also intends to have a revised proposal for the Anti-Money Laundering Directive, in the context of the fight against terrorism financing.

The advanced countries are always ahead in safeguarding the interests of economies and nations. One can only expect that other regional aggrupations and countries will subsequently adopt the world's best practices to be worthy of membership in the league of nations.

A GLOBAL CALL TO FIGHT CORRUPTION

By CONCHITA L. MANABAT, President of the Development Center for Finance and a Trustee of the FINEX Development & Research Foundation. A past Chair of International Association of Financial Executives Institutes (IAFEI), she now serves as the Chairperson of the Advisory Council of the said organization. She is also a member of the Advisory Group of the International Ethics Standards Board for Accountants. Article as of July 2016

"Defeating corruption—and thus immeasurably improving the lives of citizens—can only be achieved through re-energized collaboration between, and commitment of, leaders from both the public and private sectors. Both sectors require transparent, consistent and robust anti-corruption measures, and effective internal controls that are critical to good governance and holding officials accountable. A greater focus on strong governance and compliance structures will help cultivate self-reporting cultures that empower individuals to do the right thing."
Olivia F. Kirtley
President, International Federation of Accountants

The Organization on Economic Co-operation & Development (OECD) hosted a ministerial meeting on the Anti-Bribery Convention in Paris last March 16, 2016. Some 42 state representatives together with other heads of international organizations and leaders from the private sector and civil society were in attendance. The deliberations focused on the following :

- Whistleblower protection and facilitating voluntary disclosure;
- International cooperation; and
- Anti-corruption compliance.

The OECD has a Working Group on Bribery in International Business Transactions and the Anti-Bribery Convention has been in place for 17 years. The Working Group has been leading the monitoring and promoting the full implementation of the Anti-Bribery Convention.
The state parties to the Convention collectively

reaffirmed their resolve to take on the challenge of effective enforcement of foreign bribery laws, promote the Anti-Bribery Convention's principles in each of the represented countries, and encourage non-parties to collaborate closely with the Working Group.

The OECD initiated conference was followed by a landmark international anti-corruption summit in London on May 12 hosted by the UK Prime Minister David Cameron. A first of its kind, the summit brought together world leaders, business and civil society to tackle corruption. The discussions covered corporate secrecy, government transparency, the enforcement of international anti-corruption laws and the strengthening of international institutions. Participants agreed to a package of practical steps to :

- expose corruption so there is nowhere to hide
- punish the perpetrators and support those affected by corruption
- drive out the culture of corruption wherever it exists

The sequence of international events highlights the need to fight corruption.

Close to home, the Filipino people gave a landslide victory to a "hardliner city mayor" to become the new President of the Republic. Most political analysts interpret the results of the recently held political exercise as the peoples' protest vote to the status quo and a call for change - prompt actions to address crimes and corruption, the battle cry of the presumptive President.

Globally and nationally, the clamor for what is right and prompt actions to make things right has come to fore. The new order calls for STOP corruption, PUNISH the perpetrators, and ASSIST those who suffered from corruption. Let us rally for what is right and may Law & Order prevail.

THE FLEXIBILITY BELONGS TO THE DNA OF TUI

THE CFO OF THE WORLD´S LARGEST TOURIST GROUP ABOUT THE CONSEQUENCES OF THE BREXIT AND OF THE TERROR ATTACKS, ABOUT THE SUB-GROUP HAPAG-LLOYD, AND THE FIRM´S RATING.

Interview with Mr Horst Baier, CFO of Tui Group, Börsen-Zeitung, June 25, 2016, article provided by GEFIU, Association of Chief Financial Officers Germany, the German IAFEI Member Institute

Mr. Baier, how do you assess the decision of the British to leave the European Union?

I am a fully convinced European, and I regret, that the British have decided for an exit. But naturally we have to respect the democratic decision of the British citizens. Now it is up to the British government, to manage this vote in a level headed way - as well politically, as well as economically.

Which consequences do you expect for Europe, which ones for Great Britain?

It is difficult to evaluate the consequences so shortly after the referendum. At least for the short term, the decision will produce uncertainty in Europe and Great Britain. And uncertainty influences the consumer behaviour, entrepreneurial decisions and naturally the financial markets.

What does the Brexit mean for the Tui Group?

Should the British Pound devalue in a sustained manner, then this will certainly impact the purchasing power of the British. This makes holidays more expensive. But it has to be questioned, whether the British will thereby let diminish their marked pleasure for travelling. In addition, we are selling by around 60 % all-inclusive products in the UK and thus offer planning security. Even when Great Britain is an important market for us, we are still a globally active corporation group.
And the growth outlook for the worldwide tourism is very positive. Insofar we are confident, that we can keep the effects small.

How high are sales and profit contribution of the business in Great Britain, and which effects do you expect from the exchange rate effects?

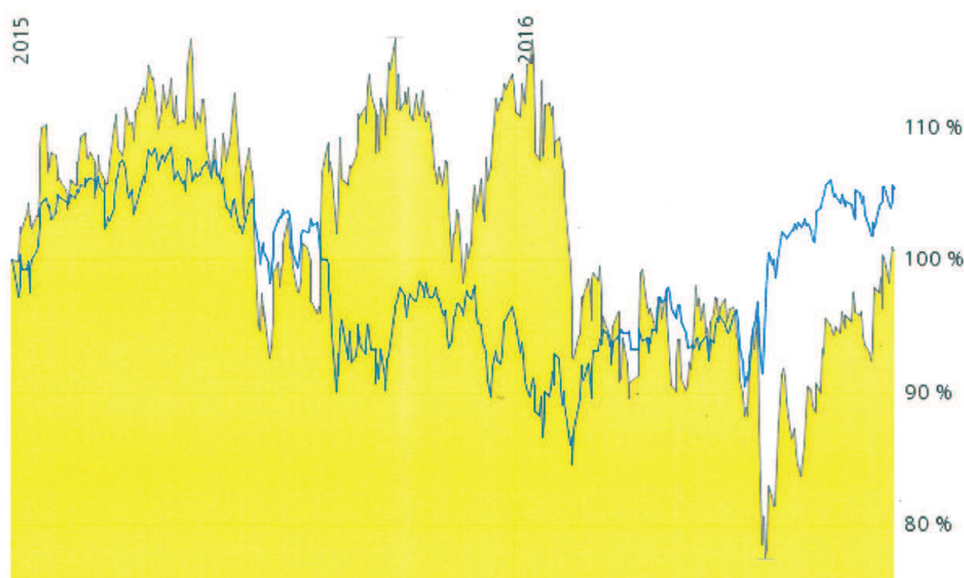
Great Britain has contributed last year roundabout one third of group sales of roundabout 20 billion €, and it is thus approximately as big as the German business. For the present business year and the business year 2016/ 2017 we have acted like previously as to hedging for currency fluctuations and for prices of kerosine jet fuel. Real risks relevant to profitability are not resulting from the decisions for the current year. From the translation of profits from pound to € we shall however feel an effect in the profit and loss statement.

Which consequences has the Brexit for the London financial market? Could the Brexit have the effect, that the listing of your stock on the London Stock Exchange could be challenged?

We have already said clearly before the referendum, that through a Brexit nothing would change as to the listing of our stock on the stock exchange and its inclusion in the FTSE100 Index. London will be an important financial market also in the future, where many of our shareholders will be active.

Does Tui, in view of the latest developments, hold on to its profit forecast for the current business year 2015/ 2016? Tourism is presently impacted by terrorism.

We are continuing to sense at our customers very clearly the passion for travelling. However, the demand from our main markets for travelling to Turkey and Egypt is presently not as big as in the past. To this, however, we can react as a group with our present positioning in a flexible way. Especially our customers in Scandinavia, in the Netherlands, or in Great Britain are turning more towards travel targets in the Caribbean. Also there are significantly increasing bookings in Spain, the Canary Islands and in the Cape Verde Islands.
Also our cruise ship business is growing in an enjoyable way. The present abstaining from single markets, we can balance offby the variety of our other group offers. Tui offers holiday schemes in more than l 00 countries, and thereby we can react well to changes in the demand structure. Therefore we are holding on to our profit target of an increase of our adjusted operating profit EBITA by at least l O % on the basis of constant exchange rates in the present year.



TUI AG Share, 1.097,00 GBp Share Price as of September 30, 2016, London Stock Exchange

lndex Price Chart, Index-base as of January 2, 2015 = l 00
-Black line TUI AG Share
-Blue line FTSE 100 lndex = 100 Large Cap United Kingdom Corporations lndex

How big are the losses in the crisis areas?

The situation in Northern Africa is mixed. The region with the countries Morocco, Tunisia and Egypt stands altogether for less than 10 % of the bookings in the group. For Morocco there are hardly any changes, but the demand for Tunisia is almost at zero. This is also true for the holiday destination Sharm El Sheikh in Egypt, whereas we continue to register demand for Hurghada. We estimate, that the number of our customers for Turkey will be halved this year. Turkey as a summer destination stands for 14 % of our bookings, in normal years we are counting 2 million guests.

This is a material decrease.

Turkey could become the destination for the Last-Minute-Business 2016, because here is a very good price to performance relationship, and because other destinations are already highly being utilised. This is painful, but it changes nothing regarding our group forecast. On the one hand we can utilise the capacities, which to use we have obligated ourselves. On the other hand, the high demand for instance for destinations in the Canary Islands and the Cape Verde Islands enables us to have higher profit contributions, which at least compensate for the slow demand for Turkey and for parts of Northern Africa.

Which balance sheet effects are resulting from the regional shifts of customer demand? By how much do you have to correct the valuations of own hotels in Egypt and Turkey?

We have invested in Egypt since the end of the nineties jointly with our partner. Through this joint venture we own a total of twelve hotels. We have had very good years with the Egypt tourism, in which the hotels produced profits. The at-equity-book value, as it is in our balance sheet today, is not in danger through the present situation. There is not any more a noteworthy book value. In Turkey we have ten own hotels. Our strength is the integrated business model, and thus we shall fill these hotels. The Turkish holiday regions remain attractive, and the hotels owners are emphasising quality and service - especially now.

TUI at a glance

Group Numbers

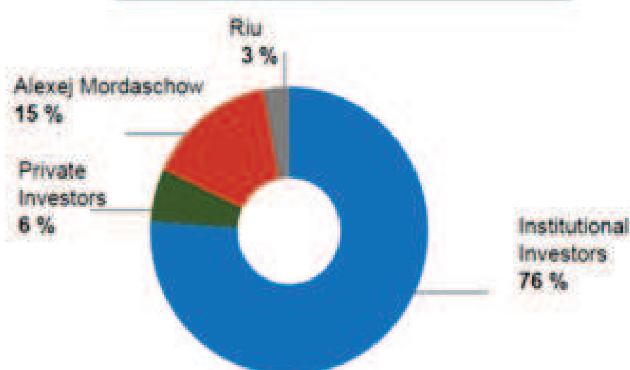
*First half of the financial year each**

	2014/15	2015/16
Sales in million Euro	6612	6792
Adjusted Ebit** in million Euro	-283	-237
Period Result in million Euro	-219	-395
Net Debt in million Euro	1694	1407

Rating	
Standard & Poor's	BB- (positive)
Moody's	Ba2 (strong)

*Financial year ends September 30
** Profit before interest, tax and depreciation

Shareholder Structure



Market capitalization
Status June 24, 2016
5.16 billion Euro

Source: Corporation, Thomson Reuters

Does the growing danger of terrorism lead to consequences for the business strategy and the orientation of the Group?

Surprising events, which have immediate and recognisable effects on the business, have occurred again and again in the past. I am active for the group since 1996. In this period we had events like the terror attack of 9 September 2001, the tsunami in South East Asia in 2004, the ash cloud of Iceland in 2010, and also the attack a year ago on the hotel location near the Tunesian town of Sousse, and all these had serious effects on the tourism industry and on ourselves. But we can react quickly to such effects. What characterises the group today especially, is that we have a high degree of capability to adapt. Flexibility is part of the DNA of Tui.

Are there considerations, or plans, to reduce the engagement in regions like Turkey and Egypt, in the future?

The Tui Group is also a portfolio manager. We are examining regularly, where we want to be invested, where we want to act as tourism loan provider with partnering hotels, and where we purchase hotels. For such decisions we have clear criteria. At present our capital expenditure concentrates on 365 – day – destinations - that is there, where the whole year round the sun is shining and where we have utilisation all year round. The positioning of Tui has changed materially.

Can you explain this with more detail?

Formerly we had sold out of Europe sun holidays. This was a merchandise philosophy, once with higher margins, once with lower margins. Toda we are much more a product enterprise, we are becoming a hotel group and cruise ship group. With our own distribution channels. We have become through our ongoing transformation much more stable with our business development. The seasonal impact has diminished.

Does the new stability and sustainability of the business model also have an effect on the future dividend policy? Is there a plan for a stable upward moving range?

Our present dividend does already compare well. With a return of over 4 % we are already a very attractive investment. Also, when having taken over the British Tui Travel at the end of 2014 we have already made a statement on the dividend for three years into the future At this moment more has not to be said to this.

Is then the reshaping of the group, the reshaping of the portfolio now coming to an end?

In spring we have sold our division hotel beds and we now also want to divest our specialty businesses. These are very good businesses, but for our group they generate no synergistic effects. This is also true for our container freightliner business Hapag Lloyd. We have firmly decided, to divest our remaining share of 12,5 %, when a suitable opportunity occurs.

The news about a planned merger with the Arabian rival UASC has revived the share price of Hapag Lloyd, but in the meantime it is again significantly below the issuing price of the IPO of November 2015 of 20,- €. What would be a suitable share price, at which you would sell the participation?

The Hapag Lloyd participation dates back to a time, when the name of Tui still was Preussag and when it was not a pure tourism group. In the crisis years of the ship traffic industry we have done a lot for Hapag Lloyd. Not least did we support the IPO, because it has provided for Hapag Lloyd the access to the capital market. This financing option is very important for a capital intensive business. The IPO, however, was also important, because the share can now be used as an acquisition currency. The tradability of the shares of Hapag Lloyd makes transactions, based on shares, possible. Hapag Lloyd, because of the intensified price war and competition in the container ship traffic industry, must grow further. Therefore we support the plan of a merger with UASC. We want, when time will have come, to divest our participation at a good price.

With which value is the share recorded in the books?

As of March 31, 2016, we have written off the participation to 16,10 € per share. Presently the share price is at 18,- €. We do not expect a further need for depreciation.

The holding period for the participation, after the IPO, has elapsed at the beginning of May. Is there a chance, that you exit still in this year?

To this, I do not say anything.

When you will have divested the Hapag-Lloyd participation, will then the reshaping to the "new" Tui be completed, after the merger with Tui Travel?

The Tui Group is changing permanently. We shall continue to invest in hotels, because we know, that in a yearly and family vacation the hotel is the most important element with which we can differentiate. We extend the cruise ship business. We shall take on July 15, 2015, the "My Ship 5" into the Tui cruises ship fleet. In the years 2017 to 2019 three more ships will be added. Parallel to this we are modernising the British cruise ship fleet. There, two weeks ago, in Palma, we have taken up a new ship into our fleet, the "Tui Discovery". We shall be capable, to develop the cruise ship business in Great Britain as successfully, as we did in the German speaking markets.

By leaving behind the merchandiser philosophy, and by investing increasingly in hotels and expensive cruise ships, also the invested capital is increasing. How as an example do you finance the expansion in the cruise ship business?

The Tui has, as it relates to its financing, a long way behind itself. There have been times, where our rating did give cause again and again to criticism by the analysts. Today we are hailed for our strong balance sheet. I am partially sharing this opinion.

What do you mean with this?

Moody`s has upgraded us in April to "Ba2". With this, we are operating almost at the level with other corporations which are active in the vicinity of the tourism industry, such as large hotel groups and large airlines. These corporation are rated in the range of "BB+" to "BBB-". To this we belong.

Are you striving for an investment grade rating ?

Up to the investment grade rating level, we are still missing something. But I am though not in all points happy about the way with which the rating agencies are looking at us. What worries us, is not so much the financial ratios, on which the rating are based, but the non financial aspects. We are still very strongly regarded as a seasonal and cyclically driven business. This is as travel organiser and merchant. But we have shown in the past year, and also before, that we have left this corner and that the transformation is working well: We are not any longer a merchant, but a product oriented enterprise. We are running more than 300 hotels, and three successful cruise ship companies, with Hapag Lloyd Cruises in the luxury segment, Tui Cruises, and Thomson Cruises. We must bring this "new Tui" even stronger to the attention of the rating agencies.

Which rating range are you striving for ?

A rating in the crossover segment we regard as adequate. The additives to this, we bring along with us today.

How much of the revenues from the sale of Hotelbeds and of the Specialty Business do you utilise for the growth financing and for strengthening the balance sheet ?

We pursue, as said, a clear ratting target in the crossover segment, but we are not planning for a defined amount of paying back debt. It is decisive, how much profit growth and cash can be generated from the new investments and how this relates to the interest expense. The interest coverage and debt ratio are relevant steering criteria, which we observe. We intend to have the Group with its products on a sustained growth course. The financial means, which are coming in from this, are being reinvested - for instance in hotels and cruise ships, but also in IT platforms, which do help, to improve the service for our guests.

Which criteria do you apply at this?

We are striving at the new investments for a 15 % return on the capital employed. Therefore we prefer at our investments the 365-day-destinations, also hotels in regions, which have high season all year long. Cruise ships have this too.

Do you see presently need for action, as relates to your financing structure?

We are having a revolving credit facility, which is the backbone of our financing. This facility we do need, in order to cope with our presently still existing seasonality in financial terms - so to say to come over the winter. Through the sale of Hotelbeds and the sale of Specialty Offerers the seasonal swing is becoming smoother. Also in this regard we are becoming more stable. That means, that as a trend we shall make less use of the revolving facility, compared with the past. As well we achieve an improvement at the working capital.

Which size has the facility?

The credit facility is 1,5 billion €. The conditions of the credit line are improving for us, when the rating will be raised. As a bread and butter financing further counts a bond facility of 215 million €. To this adds our High Yield Bond Issue of 300 million €, which we have arranged at the time of the merger with Tui Travel, in order to formally have sufficient financial means. We are paying

for this five year maturity bond a coupon of 4,5 %.

Do you presently have plans, to refinance this bond?

We are regularly looking at our financings, in order to see, whether and how we can optimise them.

How do you evaluate the progress at the optimisation of the German business?

With the profit contribution of our German organisation we are not yet satisfied - especially when comparing with other regions like North America. We have re-set the switches, we have exchanged the management. We still must improve sales and distribution, the structures have to become leaner. This will take some more time.

Which role play acquisitions?

When there is a fit with our strategy, and when our return requirements are met, then acquisitions play a role. An example for this is France, where we have acquired the Transat, and where Tui in the luxury segment now becomes market leader. France for a long time was a difficult market for us with losses. With the purchase of Transat we create the prerequisite, that we can produce synergies and can reach attractive margins over the foreseeable future.

When?

We have just signed the purchasing contract, now we have to put in place the merger. As a new market leader I expect positive returns in 2018/ 2019.

Are you planning additional acquisitions?

At present, no.

About the Person:

Collector of bycicles.

Since two decades Horst Baier is associated with Tui. Since the now 59 year old joined the company as head of finance an d accounting in 1996, thigs, as he says, have never been dull. Since then Tui has changed enormously. He in the meantime counts his nine employment contracts with the company. A certain joy for adventure has kept him in the company. New motion has arisen through Fritz Joussen having moved up to the position of the Chairman of the board in February 2013 - at the end of 2014 ensued the log desired merger with the British tourism subsidiary Tui Travel.

Baier, born on October 1956 in Hannover, started his career, after a dual education to the MBA at the Leibnitz Academy and at the continental Group in 1979 at this tire producer, which as well is located in Hannover. Further employments followed, among others at General Tyre and at the Schickedanz Group, before he came to Tui.

2007 Baier was appointed to the managing board as controller, three years later he took over the finance function. From September 2012till end of 2014, Baier, who is a father of two adult children, was as well human resources director. As a hobby the Tui-CFO has a bycicle collection.

THE INTERVIEW WAS MADE BY HEIDE ROHDE AND CARSTEN STEEVENS., BÖRSEN-ZEITUNG, FRANKFURT AM MAIN, GERMANY, JUNE 25, 2016.
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FISCAL STATE AID: WHAT CONCLUSIONS MAY BE DRAWN FROM THE EU'S RESERVATIONS

by **PIERGIORGIO VALENTE**
Chairman IAFEI International Tax Committee Managing Partner of Valente Associati GEB Partners

Introduction

Tax evasion has remained in the top of the "heatedly-debated-issues" charts for several years and is not expected to "drop down" soon. Instead, the intensity in the fight against it seems to be increasing on every occasion (Lux Leaks, Panama Papers etc.). In this "war", European Commission's (EU) decisions on fiscal state aid are beyond doubt the most controversial "weapon". In essence, such decisions invalidate tax rulings issued by Member States since they allow multinationals (MNEs) to pay less tax than standalone companies in comparable situations under Member States' tax laws in violation of state aid rules. Apple[1] , Starbucks[2], Fiat[3] are some of the most striking cases where EU, applying the above rules, ordered payment to the relevant member state of unpaid taxes amounting from € 20-30 million to € 13 billion.
McDonald's[4] and Amazon's cases are still pending while new ones are being opened on an alarmingly regular basis. For MNEs, these imply (i) increased risk of tax rulings becoming subject to investigation as well as (ii) the end of the illusion that tax rulings can actually guarantee immunity agreed transfer prices (TP).

In addition, potential discovery of reasons for the EU to open a case or – worse – to issue a decision on the existence of fiscal state aid means huge costs for the MNE, not only in terms of recovery but also of reputational damage. In light of the above, it is crucial that boards are fully aware of the current developments in the area of fiscal state aid and their implications and take them into account in their tax risk management policies. This article gives an overview of the most recent EU actions in the field and the lessons to be learned therefrom.

Cases: Apple, Starbucks, Fiat

Very recently, Ireland was found to have granted state aid to Apple by virtue of a tax ruling issued in 1991 and revised in 2007. These two tax rulings constitute the agreement between Ireland and Apple on the method for the calculation of the net profit of the Irish PEs of two Apple-group companies[5]. The remaining profit was allocated to the "head offices" of the PEs, which however were found to exist "only on paper"; in fact before the opening of the investigation, Ireland admitted that "the territory of tax residency […] was not identified."

It follows that the residual net profit remained untaxed. The decision opening the case[6] referred to the following discrepancies in the tax rulings in question: (i) inappropriate use of operating costs as net profit indicator for the application of Transactional Net Margin Method (TNMM) where specific know-how is/was identified; (ii) lack of any justification for mark-up on operating costs[7]; (iii) untenable justification for the use of lower mark-up for costs exceeding specified amount[8]; (iv) lack of justification for the existence of a capital allowance claim as well as the limit relating the-

1 http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38373
2 http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38374
3 http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38375
4 http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38945; http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_38944

5 Apple Operations Europe and Apple Sales International
6 The final decision of the EU is not publicly available yet. We refer to C(2014) 3606 final dated June 11, 2014
7 The mark-up seemed to be the result of reverse engineering, on the basis of the amount of net profit desired as the end result.
8 EC noted that "employment considerations" cannot constitute a valid reason in the context of application of the arm's length principle.

reto; and (v) open-end duration (in fact effectiveness for 15 years) implying lack of adjustment to changing circumstances.
It is worth noting that no TP report had been submitted.
The Netherlands and Luxembourg were also found to have conferred state aid to Starbucks and Fiat accordingly by virtue of tax rulings confirming the TP reports presented.

In particular, the Netherlands affirmed the calculation of the net profit of the Dutch subsidiary[9] applying TNMM and using operating costs - (considered) relevant to value adding activities of such subsidiary as net profit indicator. The remaining profit was paid as royalty to (related) UK partnership, which was not liable to pay corporate tax in the UK. Most strikingly, the amount of the royalty was not itself calculated at arm's length. The EU applied the principle using as comparables agreements concluded either by Starbucks with independent parties or by their competitors on the market; in addition it took into account the lack of (i) any benefit for the Dutch subsidiary from the exploitation of the know-how for which the royalty was paid and (ii) any other justification of the payment (services offered/risks undertaken).

They reached the conclusion that no royalty should have been paid. Another discrepancy was the non- application of the arm's length principle on COGS (cost of goods sold) which were however deductible from the accounting profits of the Dutch subsidiary. It is further relevant that the tax ruling would be effective for 10 years. In the Fiat case, EU acknowledged that TNMM is appropriate for the calculation of the arm's length profit of enterprises, such as financial institutions or the Fiat subsidiary, engaging in financial transactions with different counterparties and under different terms; in such cases capital is an appropriate net profit indicator. However, there were derogations from the arm's length principle: (i) underestimation of capital to be remunerated by misapplication; (ii) the capital in excess of the thus (under)estimated figure was inappropriately deducted from the capital to be remunerated as "equity supporting investments in foreign group members" and (iii) return on the thus calculated (hypothetical regulatory) capital was inappropriately estimated on Capital Asset Pricing Model (CAPM), the application of which was not flawless either[10].

9 Starbucks Manufacturing BV
10 According to EC, CAPM should be used on accounting entity and not on regulatory capital; moreover the beta used for the application of CAPM was calculated (i) on the basis of inappropriate comparables; and (ii) without taking into account important functions of the subsidiary.

EU notice on the notion of state aid

Guidance with respect to tax rulings may be found in the notice published in July by the EU on the notion of state aid[11]. The notice clarifies that tax rulings may (only) ascertain TP leading to a "reliable approximation of a market based outcome". Point of reference should be the prices that "would be charged in conditions of free competition between independent undertakings negotiating under comparable circumstances"[12]. The resulting tax liability should not be more favourable compared to standalone companies. As regards OECD TP Guidelines, it is highlighted that tax rulings endorsing TP arrangements (i) complying with such Guidelines, including the guidance on the choice of the most appropriate method and (ii) leading to a reliable approximation of a market-based outcome, are unlikely to be considered as giving rise to state aid.

Implications for MNEs and Conclusion

It is arguable whether the steps taken by the EU in the area of fiscal state aid answer more questions than they raise. Its decisions have been heavily criticized for damaging legal certainty. Indeed MNEs cannot and should not rely on tax rulings as an appropriate defense of their TP practices, regardless of their being acts of sovereign states. With respect to the notice, it is argued – and justifiably so – that it inappropriately focuses on comparability of standalone and group entities[13]. In any case there is room for improvement: transfer pricing is in essence an economic concept requiring precise and economic-scientific rules that would be applied without large margins for appreciation and hence for disagreement. Nevertheless, it cannot be denied that all the above are steps towards a clearer construction of state aid rules, including application of arm's length principle, and there are useful lessons to be learned therefrom:

1. TP reports should be fully substantiated, with reference to any and all factual and economic elements;
2. OECD TP Guidelines should be followed as closely as possible;
3. Practices considered inappropriate or even questionable by the EU in its state aid decisions, such as those mentioned above should be avoided;
4. All results should help to "survive" the scrutiny of the rationale underlying the "prudent independent operator acting under free competition market conditions;"
5. Tax rulings should not be requested or granted for

11 http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2016.262.01.0001.01.ENG&toc=OJ:C:2016:262:TOC
12 Belgium and Forum 187 v Commission, Joined cases C-182/03 and C-217/03
13 Nicolaides P. State Aid Rules and Transfer Pricing. Available at: http://stateaidhub.eu/blogs/stateaiduncovered/post/6730

more than five (5) years[14] and should be reviewed, if already agreed for such longer period.

As EU has repeatedly noted, “tax rulings as such are perfectly legal” and they have a particularly important function, i.e., “establishment in advance of the application of the ordinary legal system to a particular case in view of its specific facts and circumstances.”

They can and they do provide legal certainty as regards tax treatment of a specific transaction by the issuing member state. They do so more than any other available alternative. What the herein examined developments show is that tax rulings are not immune to scrutiny in marginal cases: unfair arrangements shall be screened and condemned, regardless of any “tax-ruling cover”. The moral of the story may be that MNEs can still rely on tax rulings, provided that all relevant elements are fully and properly justified in accordance with OECD TP Guidelines. On the other hand, EU should not be discouraged from further clarification of the applicable rules.

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14 EC notes in Apple decision (see footnote 1).

Speech Pretoria, South Africa | 30.08.2016
Dr Andreas Dombret Member of the Executive Board of the Deutsche Bundesbank

From dream to reality - How finance serves the economy, and how not

Speech delivered at the South African Institute for International Affairs, University of Pretoria

- 1 Introduction
- 2 Old temptations … and relapse into old patterns?
- 3 The dream of finance-led growth
- 4 …and the reality
- 5 The task: Finance for the future
- 6 Conclusion

1 Introduction

Ladies and gentlemen

Dreams can be built - at least, if you believe the movie Inception. In that motion picture's scenario, a technology has been developed that allows one to enter another person's dream. In that dream, then, thoughts can be planted - or incepted. For this, the intruder needs to construct a dream scenario inside the target person's dream.

By incepting an idea in a person's mind, his actions in the real world can be manipulated.

Unfortunately, politics sometimes shows surprising parallels to the world of cinema - in politics, colourfully painted dreams are often used to sway voters.

But all too often, political dreams are built on a limited understanding of reality. That's why they are bound to crumble. That's why swayed voters wake up to a nightmare version of reality.

Such a dream world is the political strategy of finance-led growth, a dominant political ideology since the 1980s. The dream goes as follows: growth of financial markets fuels investment; and in this way, it leads to an increase in wealth and well-being for all people.

Many people, among them the majority of experts, believed this to be true - explicitly or implicitly. However sophisticated the construct of the dream, it did not pass the test of reality. It crashed hard when the financial crisis erupted in 2007.

Nine years later, one might think that we would have sorted out what went wrong. And so we have, to an extent: we have learned that markets cannot regulate themselves; they do not work without rules. That's why we devised far-reaching reforms.

But unfortunately, we are still struggling with perhaps the most important lesson. In our quest for well-being, the dream of finance-led growth has still not been replaced with more realistic policies. As memories of the crisis fade, decision makers are once again pushing for finance to produce illusionary wealth.

Today, I want to talk to you about the dreams and the reality of finance-led growth - about what finance can deliver, and what not.

2 Old temptations … and relapse into old patterns?

Immediately after the financial crisis struck, stringent financial market regulation was considered to be the silver bullet to end the excesses of the financial industry. The idea was that strict rules would end banks' risky behaviour to ensure they never again take down entire economies with them.

As memories of the crisis fade, this attitude is becoming less visible. The general public and the policy makers are faced with other, more pressing worries - in the economic sector these are, notably, concerns about growth. In this context we refer, in particular, to emerging market economies such as South Africa and China, as well as to the euro area. We bemoan low growth levels because growth is seen to be the main source of jobs and prosperity.

Unfortunately, this policy logic causes us, time and again, to seek a quick fix - fast, easy-to-understand and convincing solutions. This makes the finance-led growth dream the ideal mantra.

3 The dream of finance-led growth

Greater growth through increased credit and enhanced financial market activity has long been an attractive policy idea. It is held to be a magic formula for economic development, the rationale being that higher levels of debt and liquidity at financial institutions lead to increased lending. This, in turn, promotes investment and therefore growth and so, finally, economic development.

All too often, policy decisions are driven by this seductive notion - or by fear of missing out on the growth that's been promised. The problem with this idea, however, is that it's flawed. Which makes finance-led growth a truly dangerous dream.

Believing the dream that greater growth is created by the financial markets, there are many who would like to see financial institutions given kid-glove treatment - meaning that credit institutions should be subjected to less stringent regulation and supervision.

We saw something along those lines before the last financial crisis. Calls for bigger and more liquid financial markets that encourage investment and lending to the private sector, thereby leading - so the idea goes - to more growth, put deregulation and lenient supervision on the policy agenda.

Economic theory and empirical evidence backed up this policy. Various studies pointed to a positive correlation between the volume of loans granted to the private sector and economic development[1] These results would appear to confirm the finance-led growth dream. I will come back to this.

But is the situation the same for advanced economies on the one hand and emerging ones, like South Africa, on the other? Well, not entirely. For these economies, experts and policy makers

had - in addition to finance-led growth - a further dream ready: that of growth through openness to international capital flows. The dream suggested that developing and emerging economies should allow international finance to enter the country without restrictions. Such a capital account liberalisation, as it is called, would lead to higher growth rates. The dream was constructed on the basis of state-of-the-art economic theory at that time. And most developing and emerging economies went along with it.

4 …and the reality

Both dreams crumbled once they were hit by a financial crisis.

The growth through capital liberalisation dream fell apart with the onset of the Asian financial crisis in 1997. Since then, studies have clearly shown that capital liberalisation has no direct positive effect on growth, and only rarely has an indirect one as a result of improving markets. Rather, it seems that those countries grow faster that rely less, not more, on foreign capital.[2]

Most importantly, the studies suggest one crucial insight: whether capital liberalisation is a good thing for an economy depends heavily on its specific situation. For example, if a country has insufficient savings, foreign capital might be the solution. If, however, there are not enough incentives or opportunities to invest in a country, additional capital won't help.

Which brings me to the other dream, that of finance-led growth. This was not challenged until the financial crisis of 2007 hit. But this has changed thanks to more recent academic studies. They show that increased credit and a higher volume of financial transactions can have negative effects, too. There are two reasons why more finance can be negative.

First, higher credit volumes lead to more frequent and more serious financial crises.[3] In other words, as more credit is granted and more financial transactions are carried out, a financial system becomes more crisis-prone.

Second: the larger the mountain of debt that has built up until a crisis erupts, the more severe the crisis typically is and the longer it typically lasts.[4] Debt was at a very high level before the most recent crisis, too - which is why many economies are still suffering from the fallout.

The more growth through finance dream became the more crises through finance nightmare.

Excessive credit growth leads to greater vulnerability to crises and their consequences, but it also unleashes yet another negative effect. Most recent studies provide evidence that it really is possible to have "too much of a good thing" - which is to say too much credit and too much financial market.

Various analyses show that economies expand more slowly when they arrive at an unsustainable, excessively high credit volume.[5] These studies do not state a universally valid limit. But they do suggest that additional credit growth adversely affects growth when the ratio of total private sector loans to gross domestic product oversteps 90 to 100 per cent. Many developed economies exceeded that level before the crisis - and, unfortunately, they still exceed it today.

In a nutshell, this means that more lending and the expansion of financial market activities is not unreservedly positive. The effect is better described by an arc. Growth can pick up in times of weak economic development; at later stages of development, a further increase can have negative implications. For developed countries, this means that more financial market alone will

do little to advance prosperity. But emerging and developing countries, too, should be careful not to raise finance to unsustainable levels.

5 The task: Finance for the future

I would recommend all financial market participants and policy makers with an interest in promoting public welfare to heed these findings.

But as John Maynard Keynes once wrote about the influence of academic advice: pragmatic decision-makers who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. The false and outdated assumptions of deceased economists serve, he argued, as the basis for their decisions. At this point I make a conscious decision not to quote the man, as his wording was not especially diplomatic.[6] Unfortunately, however, the point Keynes made was spot on.

The main problem at the heart of Keynes' remark is the attraction that simple theories with clear, universal recommendations have for policy makers. By contrast, insights which would be useful, but which are more complex and inconvenient, are sadly often neglected in the heat of policy arguments.

For this reason, when we contemplate the role financial markets should play in our economy, we must discard the simplistic notion that more financial market automatically spells more development.

Instead, what we need is a better quality of financial markets. What does that mean? By and large, financial markets serve the economy through five quality assurance mechanisms. First: payment services facilitate the day-to-day exchange of goods and services. Second: the pooling of savings plays a part in funding large-scale projects. Third: the systematic review of investments and loans reduces the workload for the individual, thus leading to an increase in investment and lending activity. Fourth: after loans have been granted, this review is continued in the form of controls. Fifth: because a bank offers a wide and varied range of products, it is able to spread risks and therefore manage them better.

None of these functions contributes directly to economic growth. Rather, they are supporting functions. The main purpose of these mechanisms is to facilitate development by contributing to the efficient distribution of resources. Financial markets are not in themselves engines of growth; but every engine of growth needs a powerful catalyst. And our financial system needs to focus more on precisely that function. This is where market players, policy makers, supervisors, researchers and, of course, qualified university graduates come into the picture. Only if we all look at and steer the financial sector in terms of our long-term economic and social responsibilities will the financial system perform its supporting function successfully.

We don't need financial market transactions in a financial system that is only focussed on itself. We need banks and other institutions that take their job seriously and promote the appropriate, forward-looking investments by distributing funds efficiently. And we need banks that are prudent in their lending.

What should be done? Policies need to be chosen wisely, away from the extreme, ideologically tainted positions. We should certainly not think that our modern economies can thrive without the catalytic functions of banks and financial markets. On the other hand, we should not fall prey to claims that regulatory reform and limitations of market freedoms will hurt development.

Policies should aim to enable financial markets to work at the service of the economy - as a supporting function. At the same time, these policies should aim to limit those transactions that only serve profit-maximisation while externalising costs to taxpayers. This might imply somewhat lower volumes of financial market transactions and somewhat lower credit volumes.

What does this mean? From the perspective of banking and financial market supervisors, it means that we need to regulate risky trading strategies and risky business models more rigorously. Therefore, to give you just one example, we now expect institutions with such approaches to refinance themselves to a greater extent using equity, rather than debt.

From a political perspective, this means that we cannot rely on financial markets to fix structural political problems. For example, if it is felt that the income of low income households is growing too slowly, it is not enough to simply rely on credit institutions to finance investments in the hope that this will create jobs. This is because the financial markets would provide more loans to such households - and if this is not sustainable, it could lead to yet another financial crisis. Thus, politics must enable banks and markets to support the economy, not to fix it.

Finally, let's turn to capital liberalisation in emerging markets. Full capital account liberalisation may not be the best strategy for many developing and emerging economies. A careful analysis of national circumstances is needed here - followed by a careful choice of economic policies.[7]

Here, too, simply hoping for more finance to lead to more development is a tempting strategy, but not a promising one. As is the case in advanced economies, one cannot rely on financial markets to fix structural political problems in emerging markets either.

That being said, in countries with low savings rates, the additional funds may help to foster investment. In countries without savings restrictions, foreign capital can indirectly support the economy by improving market structures and establishing best practices. In both types of countries, it is crucial to have strong supervisory institutions as well as market regulation to provide the necessary environment for markets to function. The less countries are able to regulate and supervise markets, the more careful they should be with regard to liberalising capital movements.[8]

6 Conclusion

Ladies and gentlemen,

Dreams are an essential element of brain activity. Likewise, economic dreams and theories are essential for developing policy strategies.

However, both types of dreams become problematic if taken at face value, and without careful analysis. The dreams of finance-led growth and growth through capital liberalisation have turned into nightmares - and clinging to them will do us no good. We need to find a new path to guide our economies into better territory.

Credit, banks, and financial markets - no doubt - will play a key role in that strategy. But growth will not be finance-led - it will be finance-supported.

Thank you for your attention.

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July 2016

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Asia ex Japan Equities—Unlocking the Value

HAVE WE REACHED AN INFLECTION POINT?

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Portfolio Manager, Asia Opportunities Strategy

KEY POINTS

- Asia ex Japan equity market valuations are currently at multiyear lows, well below long-term average levels.
- While there is attractive valuation potential at such levels, in order to unlock this value, we need to see an improvement in corporate earnings and return on equity.
- Importantly, over recent years, company management teams have slowly adjusted to the economic realities of today, modifying practices and showing greater discipline, particularly in relation to spending.
- There is some evidence that these efforts are beginning to bear fruit, signaling a potential inflection point for Asia ex Japan equities following years of underperformance relative to other major equity markets.

"Are Asia ex Japan equity valuations really cheap?" This is a question that investors have been asking for some time now, as valuations in the region have been progressively derated in recent years. On a historical basis, Asia ex Japan equity market valuations are well below long-term averages, with price-to-earnings (P/E) and price-to-book (P/B) metrics currently toward the lower end of their 20-year ranges. Only four times in history has the P/B ratio on the Asian equity market been lower than it currently is (Figure 1).

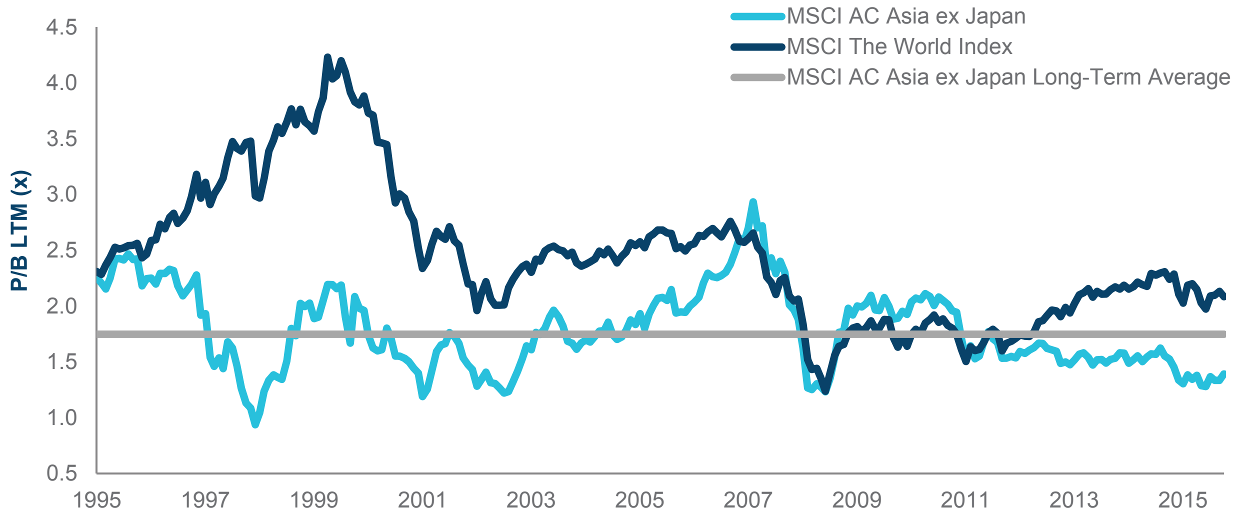
However, while there is little doubt that the market is optically cheap, it is also true that it is cheap for a reason, as return on equity has declined and earnings have disappointed. With this in mind, the crucial question investors are asking is: What needs to happen for the value in Asian equities to be unlocked?

RELEASING THE VALUE IN ASIA—WHAT NEEDS TO HAPPEN?

A range of factors have influenced the movement of the Asia ex Japan equity market in recent years, from global monetary policy, a stronger U.S. dollar, weaker global trade

Figure 1: **Asia ex Japan valuations are at historically cheap levels**

As of June 30, 2016



Sources: FactSet and Thomson Reuters.

and, of course, the significant impact of slowing economic growth in China. The negative impact of these macroeconomic influences on Asian economies has been reflected in a protracted period of weak corporate earnings growth exacerbated by a combination of overinvestment, excessive leverage, and poor management discipline. Amid such an environment, company margins have been progressively squeezed, and returns on capital have declined. In order to see gains in Asia, this contraction needs to reverse, with expanding margins, improved returns on equity, and, ultimately, a positive rerating of Asian equities.

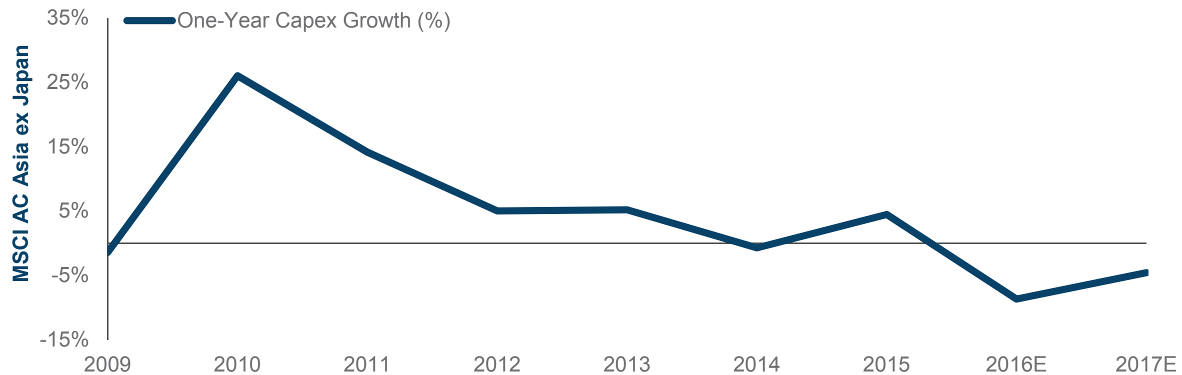
Margin expansion can be driven by various means; from topline growth (as a result of innovation or product premiumization) to a more disciplined approach to reducing costs (due to lower wages, falling raw material costs, or simply greater management focus). In addition, more disciplined capital spending should aid margins and improve returns on capital. We are beginning to see some evidence of this kind of margin improvement coming through in the Asia ex Japan region, potentially signaling a market inflection point following an extended period of disappointing earnings growth and downward revisions.

A LESSON FROM HISTORY

For a long time, too many Asian companies ignored margins, enjoying the benefits of rising topline revenues. Looking back, it is not so difficult to trace the path that led to many of the challenges facing Asian companies today. In the years following the Asian market crises of 1997–2002, companies in the region embarked on a spending spree, effectively playing catch-up after years of underinvestment. Encouraged by greater stability in the region, rising foreign investment, and resurgent economic growth, companies initiated massive investment programs aimed at boosting productivity and sales. As such, a lot of the earnings growth of the past has been achieved by expanding sales in an environment of robust economic growth. Asia also enjoyed a rapid recovery after the global financial crisis of 2008, allowing old habits to persist, and it was not until Asian economic growth began to slow from 2011 that the results of this behavior began to show. In the rush to spend, history shows us that much of this was poorly invested by ill-disciplined and overexuberant management teams and often financed by mispriced capital. The result of this irrational spending was supply gluts, excess inventory, overcapacity, and, ultimately, falling prices and contracting margins. Today, companies are finally adjusting to the new economic reality, with management teams modifying their practices to account for the tougher environment in which they are now operating.

Figure 2: **Management showing greater discipline in relation to capex**

As of December 31, 2015



Sources: FactSet and Thomson Reuters. Capex growth per calendar year (CY). Estimated for 2016–2017.

CAPITAL EXPENDITURE (CAPAX) DISCIPLINE COMING THROUGH

One area where this has been particularly evident is in the way company management teams are allocating capital. Greater discipline in relation to capex—the amount spent on maintaining/expanding the asset base—should have a material impact on the amount of free cash flow that Asian companies are generating (Figure 2). This is important because cash flow allows a company to pursue opportunities that enhance shareholder value. Without cash, it is tough for a company to develop new products, make acquisitions, pay dividends, or reduce debt.

LOWER COSTS ALSO BODE WELL FOR MARGIN IMPROVEMENT

Furthermore, profit margins in Asia have also been under pressure in recent years as wage growth has outpaced growth in productivity. This has been particularly evident in China. However, for the first time in five years in Asia, we are beginning to see wage growth moderate toward more sustainable levels. This reduction in wage-related costs should provide a positive influence on company profit margins. At the same time, lower commodity prices, particularly for energy, is also materially beneficial as lower raw material input costs again flow through to provide a boost for corporate profit margins. These are natural, cyclical factors that impact margins, but selectively across Asia, especially at the higher-quality, private sector companies within our region, we are seeing evidence that management teams are taking a more disciplined approach to managing their cost base. Companies are also realizing that they can no longer rely purely on economic growth to drive their revenues. Companies that succeed in introducing new products to drive their topline while managing costs effectively should deliver solid growth over time. This type of "self-help" is an important factor we look for through our research process.

Given the recent history of weak earnings growth and returns on capital from Asian equities, the current valuation levels are not entirely unjustified. However, signs of improvement are emerging, potentially signaling an inflection point in the market. Reduced costs are beginning to flow through to expanding company margins, while greater capex discipline is likely to lead to improved return on capital, as well as allowing companies to potentially return more cash to shareholders via dividends or by buying back shares. Investors will most likely be prepared to pay for the prospect of greater capital returns, leading to a potential positive rerating of the Asian equity market.

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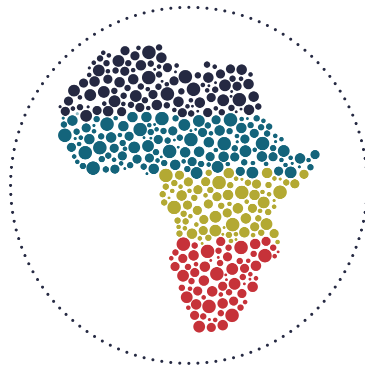

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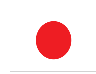
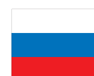
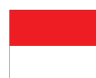
	BELGIUM		GERMANY		JAPAN		PORTUGAL
	BRAZIL		GREECE		SOUTH KOREA		RUSSIA
	CHINA		INDONESIA		MEXICO		SOUTH AFRICA
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