

IAFEI Quarterly

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47th IAFEI WORLD CONGRESS Latin America & Global Connections XXVIII CONEF Brazilian Financial Executives Congress



27 – 29 SEPTEMBER 2017 HOTEL UNIQUE SÃO PAULO - BRAZIL

-  **CFO Global Survey**
Uncertainty Slows Spending Plans in USA
-  **The Strategic Board of Directors**
A new Landscape for Global Organizations
-  **The Global FX Code of Conduct**
Supplement to any and all local laws, rules, and regulation by identifying global good practices and processes

LETTER OF THE CHAIRMAN

Dear Colleagues,

I am very pleased to inform you that in the latest Executive Committee meeting some very important decisions were made regarding the future of our Association.

In the interests of improving the value proposition offered to participating Institutes and their members, we are studying some terribly interesting projects which regard the Technical Committees, the search for new Sponsors, and for the restyling of our Web site.

I am very aware that we must do a lot more to render IAFEI more attractive, and while to date much effort has been made, the results have not yet come close to my personal targets. It is not an easy job, but the new projects now on the table should give IAFEI a much better and more dynamic and modern feel! By the end of 2017, I'm sure you will be able to appreciate the results of our work.

The hard work of the Area Presidents and the Advisory Council have resulted in the arrival of two new members, Cambodia and Spain. We all give a very warm welcome to the new colleagues from these two countries, certain that their contribution as new members will drive us to achieve even more as an association.

At the same time, we are working intensely on the upcoming IAFEI WORLD CONGRESS 2017 which will take place in Sao Paolo in Brasil from 27th to 29th September next. Our friends and members from Brasil are using all their professionalism and experience to produce a top class event, as can be seen from the important themes on



the program and from the high level of the contributors and speakers, guaranteeing a thoroughly successful congress.

I look forward to greeting as many of you as possible in Sao Paolo for a wonderful moment of comparison between the realities of so many different countries and economic regions, which will lay the foundations for our personal and business development over the next 12 months.

Best wishes for the summer holidays in the meantime!

*Fausto Cosi
IAFEI Chairman*

LETTER OF THE CHIEF EDITOR

Dear Financial Executive,

You receive the IAFEI Quarterly XXXVIIth 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 professional information tool of our association, destined to reach the desk of each financial executive, or reach him, her otherwise, at the discretion of the IAFEI member institutes.

This issue is the Seventh 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 now 11 IAFEI representatives from all continents.

There is intense discussion in world economic politics about Free Open Trade, Globalisation versus Protectionism and about the challenges from Globalisation.

This Quarterly issue contains an article by William C. Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, USA, which gives valuable guidance to and recommendable solutions to this subject of world economic politics.

Upon an initiative of the world's leading 16 Central Banks and with cooperation by market participants from around the globe, a Global FX Code of Conduct has been established and published in May, 2017. This Quarterly issue contains a presentation of the Code by Mr. Guy Debelle, Deputy Governor of the Reserve Bank of Australia, who chaired the project.

Before release of the Code, drafts of the full



text of the Code were distributed to market participants, including industry associations as well as several IAFEI member associations, for their review, to ensure all perspectives were appropriately reflected in the Code.

The Global Code itself "does not impose legal or regulatory obligations ... but rather is intended to serve as a supplement to any and all local laws, rules, and regulation by identifying global good practices and processes". For the code itself see www.globalfxc.org

Most articles of this Quarterly issue are from inside IAFEI sources. But still: More IAFEI member institutes should contribute articles. Let us jointly strive for this to happen.

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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"SURVEY OF CFOs ACROSS THE WORLD FOR THE 2ND QUARTER 2017"

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BY JOHN GRAHAM AND PHILIPPE DUPUY

CFO Survey: Uncertainty Slows Spending Plans in the US

Uncertainty about regulatory policy and health care costs is causing chief financial officers in the United States to hold back investment plans. More specifically, uncertainty about regulatory policy is putting companies in a wait and see mode, putting expansion in general on hold.

Almost 40 percent of CFOs indicated uncertainty is currently higher than normal. Among those companies, about 60 percent said that uncertainty has caused them to delay new projects and investments. If one multiplies those two numbers together, it means that current uncertainty is causing nearly 1 out of every 4 companies to delay or cancel plans. That might be enough to significantly dampen growth.

Optimism Remains Strong

The Optimism Index fell slightly this quarter to 67 on a 100-point scale. That's two points lower than last quarter but still far above the long-run average of 60. CFOs remain optimistic not only about the overall economy but about their own firms too. Hiring plans are stronger than one year ago and U.S. companies expect to pay higher wages, with median wage growth of about 3 percent over the next 12 months, even greater in the construction and tech industries.

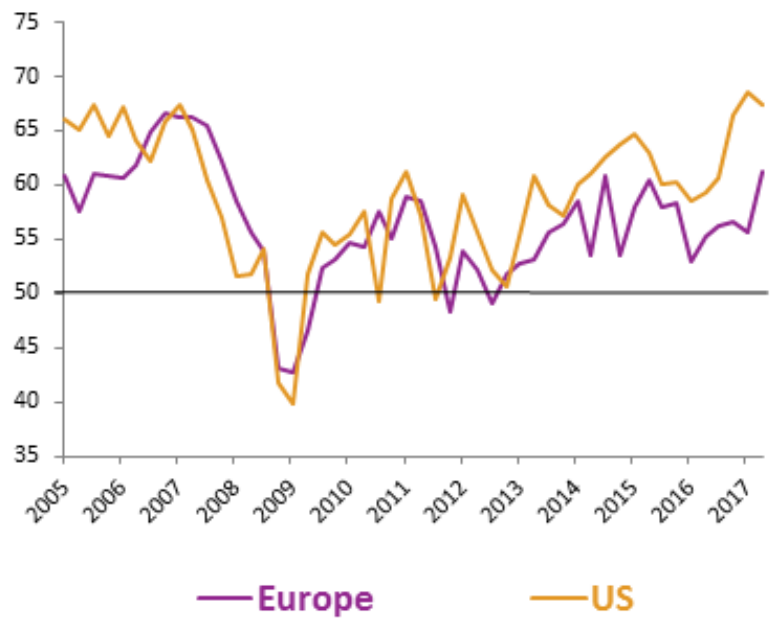
Top Concerns

This quarter, for the first time, the top concern among CFOs is difficulty hiring and retaining qualified employees. Firms are finding it harder to find qualified employees with the skill sets they seek. There are

indications of shortages of both management talent and skilled jobs such as diesel mechanics, tech engineers, and sales and service positions. Other top concerns include health care costs, which are expected to increase by more than 7 percent over

the next year; Washington gridlock and, for the first time as a top 5 concern, data security.

Table 1: During the past quarter, which items have



Global results

Optimism is up in Europe, especially in France, only a notch below U.S. optimism. Capital spending will strengthen and moderate employment growth (1.7 percent) is expected. Top concerns include economic uncertainty, attracting and retaining qualified employees, followed by governmental regulations and policies. About one in five companies say they are delaying expansion due to uncertainty about regulation and the economy. Shortage of funding and of qualified employees limits the ability to pursue certain value-creating projects (in addition to too much uncertainty about some projects and these projects not being core to the firm).

Optimism is up in Asia, nearly as high as in the U.S. Difficulty attracting employees, currency risk, and falling employee productivity are top concerns. Five percent capital spending and 2.7 percent employment growth expected. About one-third of firms say uncertainty about economic growth and tax policy are greater than normal but few Asian firms are slowing expansion plans in response. Too much uncertainty

and overly optimistic projections are primary reasons that some value-creating projects are not always pursued (in addition risk being too high and the project not being core to the firm's strategies).

Latin American CFOs have moderate optimism, up from very low levels one year ago. After dropping 6 months ago, Mexican optimism has almost fully recovered. Still, there are significant concerns about economic uncertainty and weak demand.

Business optimism in Africa is the lowest in the world. Employment outlook is weak. Biggest concerns are economic uncertainty, volatility of the political situation, and governmental policies.

Fifty-five percent say that uncertainty is worse than normal, and among these firms more than half are holding off on expansion in response. Shortage of funding limits ability to pursue value-creating projects (in addition to projects not being core to the firm and scarcity of management time).

Table 1: During the past quarter, which items have been the most pressing concerns for your company's top management team?

	Europe	Latin America	Asia	U.S.A.
Economic uncertainty	38.3	69.4	42.0	31.7
Currency risk	18.0	16.7	33.7	4.2
Weak demand	17.2	56.9	23.7	19.7
Government policies	29.7	43.1	31.3	36.2
Access to capital	21.1	23.6	15.7	11.8
Regulatory Requirements	30.5	9.7	14.5	30.3
Difficulty attracting / retaining qualified employees	33.6	6.9	34.5	41.0
Employee productivity	21.1	18.1	25.4	20.2
Rising wages and salaries	10.2	4.2	13.8	14.9
Employee morale	18.0	2.8	18.4	11.8
Cost of borrowing	4.7	22.2	4.2	6.5
Data security	25.0	6.9	22.2	31.2
Geopolitical / health crises	10.9	8.3	18.1	8.1
Deflation	2.3	1.4	3.0	0.8
Rising input or commodity				

Table 2: Relative to the previous 12 months, what will be your company's PERC ENTAGE CHANGE during the next 12 months? (mean by region)

	Europe	Latin America	Asia	U.S.A.
Revenue	5.6	3.7	3.6	6.2
Inflation (Change in prices of own-firm products)	1.7	3.2	-0.9	2.5
Capital spending	8.2	-0.6	5.4	2.2
Technology spending	6.9	2.8	3.7	4.1
R&D spending	6.7	-0.1	1.6	2.3
Advertising and marketing spending	3.9	2.5	2.0	1.8
Employment – full-time	1.7	-4.1	2.6	3.8
Wages and Salaries	3.4	3.8	3.0	4.1
Health Care Costs	2.2	5.4	5.7	7.8
Earnings growth	3.2	3.0	10.8	8.2

The survey has been conducted for 85 consecutive quarters and spans the globe, making it the world's longest-running and most comprehensive research on senior finance executives. This quarter, nearly 750 CFOs responded to the survey, which ended June 9.



Code of conduct

THE GLOBAL FX CODE OF CONDUCT

Address by Mr. GUY DEBELLE, Deputy Governor of the Reserve Bank of Australia, to the Thomson Reuters Industry Event “Examining the FX Code of Conduct”, Sydney, Australia, 15 June 2017, from central bankers’ speeches, BIS, Bank of International Settlement, Basel, Switzerland

The FX Global Code of Conduct was launched just over two weeks ago in London. It is available on the Global Foreign Exchange Committee’s website, www.globalfxc.org.¹ Today I will reiterate the motivation for the work, highlight the main features of the Code and adherence, summarise how we developed the Code and outline the way forward.

Firstly, why has this work been necessary? The foreign exchange (FX) industry has been suffering from a lack of trust. This lack of trust is evident both between participants in the market and, at least as importantly,

¹ An app version has also been made available by an external party: app.policystore.ch/C/FXCode/.

between the public and the market. The market needs to move toward a more favourable and desirable location, and allow participants to have much greater confidence that the market is functioning appropriately.

The Code sets out global principles of good practice in the FX market to provide a common set of guidance to the market. This will help to restore confidence and promote the effective functioning of the wholesale FX market.

A well-functioning FX market is very much in the interest of all market participants. This clearly includes central banks, both in their own role as market participants but

also as the exchange rate is an important channel of monetary policy transmission. In a globalised world, the foreign exchange market is one of the most vital parts of the financial plumbing.

One of the guiding principles that has underpinned our work in developing the Code is that the Code should promote a robust, fair, liquid, open and transparent market. A diverse set of buyers and sellers, supported by resilient infrastructure, should be able to confidently and effectively transact at competitive prices that reflect available market information and in a manner that conforms to acceptable standards of behaviour. Note that I am talking about all sections of the FX market: buyers, sellers and infrastructure.

The work to develop the Code began two years ago, in May 2015, when the BIS Governors commissioned a working group of the Markets Committee of the BIS (which I chaired until early January this year) to do two things: first, establish a single global code of conduct for the wholesale FX market and second, to come up with mechanisms to promote greater adherence to the Code.²

This work was very much a public sector–private sector partnership. We were ably and vigorously supported by a group of market participants, chaired by David Puth, CEO of CLS. David's group contained people from all around the world on the buy side, including corporates and asset managers, and the sell side, along with trading platforms, ECNs and non-bank participants, drawing from the various Foreign Exchange Committees (FXCs) and beyond. All parts of the market were involved in the drafting of the Code to make sure all perspectives were heard and appropriately reflected.

There are two important points worth highlighting: first, it's a single code for the whole industry and second, it's a global code.

On the first point, the Code supplants the existing codes that have been present in the FX market. So there is now one single code. Importantly, the Code covers all of the wholesale FX industry. This is not a code for just the sell side. It is there for the sell side, the buy side, non-bank participants and the platforms; it reaches around the globe and across the whole industry. The way it is relevant will depend on the nature of the engagement with the FX market. What this means in practice is that the steps different market participants take to align their activities with the principles of the Code will differ, reflecting the size, complexity, type and extent of their engagement with the FX market.

On the second point, it's a global code: our group contained representatives from the central bank and private sector from all the 16 largest FX centres, including both developed and emerging markets.

The first phase of the Code was released in May 2016. It covered areas such as ethics, information sharing, aspects of execution and confirmation and settlement. The second phase covered further aspects of execution including e-trading and platforms, prime brokerage, as well as governance, and risk management and compliance.

The complete Code comprises 55 principles spanning these issues. The principles are written in plain language and should be easily read and understood by market participants. The principles are supplemented by a suite of examples to illustrate their practical application.

Market participants had a number of opportunities to comment on the Code, in addition to the direct input of the Market Participants Group. Before its release, drafts of the full text of the Code were distributed to market participants for their review, principally through the various FXCs, but also through other industry associations to ensure all perspectives were appropriately reflected in the Code. Through this process, over 10,000 comments were received.

The Code reflects our collective judgement as to what constitutes good practice in the market, taking account of the feedback received. I think it is a good outcome of the process that we were able to distil the points of contention down to a small number of issues. Outside of these, the feedback reflected a widely held consensus as to what is good practice. The degree of consensus and the willingness to contribute to the process reflect the fact that market participants have recognised the Code's aim of helping move the FX market to a better place.

One of our central aims in drafting the Code is for it to be principles-based rather than rules-based. There are a number of reasons why this is so but, for me, an important reason is that the more prescriptive the Code is, the easier it is to get around. Rules are easier to arbitrage than principles. The more prescriptive and the more precise the code, the less people will think about what they are doing. If it's principles-based and less prescriptive then market participants will have to think about whether their actions are consistent with the principles of the Code.

But we have not written a procedures manual. Rather, we have articulated principles that need to be taken into account. Individual firms may then take these principles

² See <www.bis.org/press/p150511.htm>

and reflect them in their own procedures manuals. Our aim in setting out these principles is to provide market participants with the framework in which to think about how they, for example, handle stop-loss orders. The emphasis here is very much on the word ‘think’.

Adherence

Alongside drafting the Code, we devoted considerable time and effort to thinking about how to ensure widespread adoption of the Code by market participants. Clearly, that was an issue with the various existing codes that had been in place in a number of markets. It is evident they were ignored on occasion in the past, wilfully or otherwise.

We have worked with the industry to produce a principles-based code rather than a set of prescriptive regulatory standards. The Code is not regulation. It will not impose legal or regulatory obligations on market participants, nor will it supplant existing regulatory standards or expectations.

We have developed a blueprint for adherence that has been published alongside the Code and sets out the key elements we think will be required for the Code to be successful – and the steps that have been taken, and will be taken, to ensure this is the case.³

One critical dimension is market-based adherence mechanisms. An important element of discipline should come from the market itself. The adherence to a voluntary code will only come about if firms judge it to be in their interest and take the practical steps to ensure the Code is embedded in their practices. Such practical steps would include training their staff and putting in appropriate policies and procedures.

We have provided a draft Statement of Commitment for firms to publicly demonstrate their adherence to the Code.⁴ One reason for a public demonstration is that firms are more likely to adhere to the Code if they believe that their peers are doing so too. That is, an important source of pressure to adhere should come from other market participants. To provide visibility around this, there are a number of market-based initiatives to provide public registries where market participants can demonstrate their use of the Statement of Commitment. These registries will be in the public domain in the near future. More broadly, market participants have a vital interest, and a role to play, in promoting and upholding good practices in the market as a whole.⁵ This can be

partly achieved through leading by example, but can also be supported by having similar expectations of counterparties and other market participants and helping to raise awareness of the Code in their market interactions. In that regard, we have reached out to more than 120 industry associations and key market infrastructure providers globally. In Australia, that includes AFMA and the Finance and Treasury Association, as well as the NZFMA.

Ultimately the success of the Code in promoting integrity and restoring confidence in the wholesale FX market lies in the hands of its participants.

Another aspect of market-based adherence comes through the FXCs. In due course, adherence to the Code is likely to become a requirement of FXC membership. In Australia’s case, adherence to the Code will be a requirement of membership of the Australian foreign exchange committee by the end of this year. That would ensure the Code is embedded at the core of the FX market, given the extent of coverage of the FXCs. But it is also important that it extends beyond that, and that there is, at the very least, an awareness of it across all market participants.

A second dimension of adherence is that the BIS central banks have signalled their commitment by announcing that they themselves will follow the Code, and that they expect that their counterparties will do so too.⁶ In the case of the RBA, we will require that our counterparties sign the Statement of Commitment, just as we will ourselves.

Given that we provided the full text of the Code to the market only last month, there will be a period of time for market participants to adjust their practices where necessary to be in line with the principles in the Code. I would not expect much time should be required to do this. This period of time might potentially be as short as six months, but no more than twelve months for the vast majority of market participants. How much effort this might require will in part depend on the nature and extent of engagement with the FX market. In drafting the Code, we have always kept the principle of proportionality at front of mind.

Finally, it is vital that the Code remains up to date and evolves as the market evolves. The Code will be collectively owned, maintained and updated by the Global Foreign Exchange Committee (GFEC), which met for the first time in London in May. This will continue the public sector – private sector partnership which has supported the development of the Code.

⁶ See www.bis.org/press/p170525.htm

³ www.globalfx.org/adopting_the_global_code.htm

⁴ The Statement of Commitment is in Annex 3 of the Code

⁵ The Banking and Finance Oath has a very similar motivation www.thebfo.org/home

The GFXC will regularly assess whether new information or market developments warrant updates or additions being made to the Code. As the first example of this, given diversity of views on the use of last look in the market, the GFXC is currently requesting feedback on trading in the last look window.⁷ On a less frequent basis, the GFXC will oversee a more comprehensive review of the Code.

⁷ See www.globalfxc.org/consultative_process.htm

Conclusion

The Global Code is the culmination of two years of work by a group of people from both the private and public sectors. The work reflected a very constructive and cooperative effort between the central banks and market participants. We all undertook this work in addition to our regular responsibilities, at all hours of the day and night. This contribution of time and effort reflected the fact that all of us recognise the need to restore the public's faith in the foreign exchange market. We share the view that the Global Code plays an important role in assisting that process and also in helping improve market functioning and confidence in the market.



THE STRATEGIC BOARD OF DIRECTORS - A NEW LANDSCAPE FOR GLOBAL ORGANIZATIONS

By LUIZ ROBERTO CALADO, Vice-President, Brazilian Institute of Financial Executives (IBEF-SP), and by JOSÉ ROGÉRIO LUIZ, CEO, ITU Partners e Board Member, Sao Paulo, Brazil, article provided by IBEF, Instituto Brasileiro de Executivos de Finanças, the Brazilian IAFEI Member Institute

The Board of Directors is usually recognized as the most important governing body of a corporation. Its role is based on organizing past and present events and taking actions, evaluating competitive situations and risks, preserving and pursuing greater value to the organization.

However, in the past years, directors have been accumulating a lot of legal responsibilities and the compliance agenda has been a constant, having taken extraordinary amount of time from the directors. The fear of new regulations, corporate scandals and corruption cases are some of the issues causing this problem.

Moreover, in evaluating the composition of the Board of Directors, the profile of most of its members is an executive in the final phase of his or her career, or already retired, and for many, participation in 4 or 5 councils is their “new career”.

In a context of risk assessment, there is no doubt that this kind of experienced executive fits best to compose a Board and fulfill this function. Accustomed to past risk situations, these executives can better manage situations to be avoided.

However, by focusing on risk, the role of thinking about the future ends up being delegated to the managers directors. Thus, in many cases the CEO ceases to operate the demands and directives coming from the board, and plans to the future, without seeing what the board wants and without focusing its energy on the effective delivery of what the board demands. In this scenario, the function of the CFO is also hampered by lack of vision and by this situation, where discipline to conduct business is relatively distanced from the strategic planning, which again should be led by the Board, since one of its key roles is to create longevity for the business.

The result of this logic? Many board members and CEOs have been dismissed. Especially those who look more like statesmen than businessmen. Among them was Jeffrey Immelt of General Electric. In June 2017, he unexpectedly announced plans to retire after 16 years in office. Ford CEO Mark Fields has been in office for less than three years when he was fired last May. In common, both faced a fluctuating share price and pressure from activist investors.

With this, the baronial era of the chief executive, seated on an industrial domain with all the privileges, is coming to an end. Same with the Directors.

These events were particularly important, given the reputation of companies as training ground and inspiration for future executives from other companies.

What is the lesson to be learned? They have tried to change their organizations but have failed to react quickly enough to the forces that affect their companies. The question is, is only changing the CEO enough to change the direction of the organization? Or would it also be necessary to change the profile of the board members? The answer seems quite obvious and is already happening. Directors also need to change, evolving from family-like clubs to a much more diverse and demanding constituency. From a risk-based view to a forward-looking view.

This reflects the increased power of controlling investors, who buy shares in companies and then demand changes. They are now looking for bigger returns, requiring annual double-digit earnings growth in an economy that is still almost stagnant.

A first change brought about was to dismiss the CEOs and Chairmen, those who occupy the two positions. According to a review by Strategy & Consulting arm of PwC, in 2001, more than half of the new CEOs also took over as Chairman. Fast forward fifteen years and only 10% occupied both roles.

This is a reflection of the activist investors, who are getting, well, more active. More than 300 US companies were targeted by these investors in 2015, a huge leap from around 100 in 2010, according to the Wharton Business School study. They are also becoming more successful in gaining the seats of the board.

There needs to happen an evolution in the boards of companies, which should be less concerned with the bureaucratic role or compliance and more with the evaluation of the future of the company. They need, therefore, strategic advice. This role, previously delegated to the CEO or its managers, is now exercised by the board, in conjunction with the managers.

One of the conclusions of this analysis is that the performance evaluation of the Board and the CEO in most companies may be misguided, and this is also reflected in the financial incentives granted. With the exception of companies where Board members are also

large shareholders, there are rare situations where there are long term stock options for board members. So what would be the benefit of a director in thinking about the long-term business if they could not share the economic benefits? Another question leads to the future. Wouldn't it be interesting to have young executives on the board? Or greater gender or ethnic diversity? Certainly not for the most part, but for them to act on this bottleneck by assuming the role of risk managers and in the future to become good strategists.

Thus, recognizing that today many boards of directors focus their action with a look to the past or to legal compliance, delegating to the C-level and external consultants the task of planning the future. This takes precious time from the CFO and CEO who should focus on the most effective delivery of the present, following a plan established by the board. Any example of a company that is changing that? Petrobras. It has just created council support committees to carry out strategic planning. In order to make the council more strategic, it is also necessary to select with confidence its members, allowing a greater diversity of opinions, partly by inviting younger executives with different backgrounds, maybe including different corporate cultures by adding members that haven't spent decades on the same company. This will prevent companies from having the same fate as Kodak or Olivetti.

CASE – ONCE UPON A WHILE

It was our second meeting in a Board of Directors of a large corporation and we witnessed the following scene:
Board Member #1: We need to redefine our strategy, do you agree Mr Chairman?

Chairman: Yes, let's do it. I propose we hire a global strategic consultancy firm.

Board Member #2: Considering that most board members sited here have already participated in a strategic planning, wouldn't it be better to do that by creating committees and using our employees, thus saving more than \$ 3-5 million dollars?

Chairman: We do not have this knowledge in house.

Lesson: the chairman does not trust his own people and could throw away 3-5 million USD, spend a lot of managers and directors time with providing the consultancy with inputs, and still, even the best consultancy firms may, from time to time, make mistakes, and thus the process itself wouldn't be risk free.



AT FRANKFURT, AS AN AIRLINE ONE CAN MAKE GOOD MONEY

THE CFO OF FRAPORT ABOUT THE DISPUTE ABOUT DISCOUNTS FOR NEW ROUTES AND AIRLINES – DECISION ABOUT THE CONSTRUCTION OF THE PIER AT TERMINAL 3 IS TO BE MADE SOON

Interview with Dr. MATTHIAS ZIESCHANG, CFO, Fraport AG, Frankfurt am Main, Germany, member of the Board of GEFIU, Association of Chief Financial Officers Germany; from Börsen-Zeitung, May 3, 2017, Frankfurt am Main, Germany, article provided by GEFIU, the German IAFEI Member Institute

Mr. Zieschang, in the past months the subject incentives for low price airlines at the Frankfurt airport has been strongly debated. What is the present situation of the talks with the airlines like Lufthansa?

We continue to be in intensive talks and we make progress. One must not forget this: at Frankfurt, as an airline, one can make good money. Here, above average returns can be achieved, which makes up the attraction of this Rhein-Main-area airport. The airport is located in an economically strong region. Unfortunately, airports like Stuttgart and Cologne/Bonn at a distance of 200 km and with a stronger presence of low cost airlines, since a number of years are deviating potential clients from us. To this we have to react in the competition.

What makes this area around Frankfurt so interesting?

In our area of coverage are living 38 million federal citizens, that is almost half the population of Germany. This region economically is very strong and it has a very high purchasing power which is also reflected in the high demand for air travel.

But now it seems that there are certain approaches between Fraport and the established airlines which regard themselves as being put at a disadvantage at this site?

We have always said that we want to have a good relationship with our customers. We are convinced that we are offering a high value product. The criticized costs here is one thing, at this we are working with our partners. But the truth also is, that the airlines at Frankfurt can achieve above average returns.

But there is the threat in the room that the airlines, which are already represented here, are wishing the same discounts which are now offered to new airlines like Ryan Air.

With the incentive program we want to generate new and to the degree possible low noise traffic. The incentive program is applied indiscriminately to everybody who is offering traffic to us. Also, the program is rather limited timewise, with a discount of 50 % in the first year for

new traffic lines, a discount which will be completely be decreased over a period of 3 years.

This would also apply, when Eurowings as a new offering airline, would take over a traffic line from the parent company Lufthansa?

We are offering incentives for new traffic lines in the intercontinental traffic and for passenger growth in continental traffic. The amount of incentives for growth in the continental traffic again depends on the additional passenger growth. This of course also is applicable to Eurowings. A pure rebranding, meaning for example the substitution of Lufthansa flights by Eurowing flights would not be promoted according to the incentive regulation, because by way of this, no new traffic lines and no growth would be generated. But this is just the objective of the incentives.

The Lufthansa Airline might see this differently.

As a matter of principle: The Lufthansa Airline is our most important partner at the Frankfurt Airport, and we have a common interest to successfully further development the businesses. This also relates to Eurowings. We have a close exchange of opinions, how we get ahead our good partnership over the longer term and how we can reinforce it. Naturally, one also has to understand that on short range flights the product differentiation becomes ever more difficult between low cost carriers and network carriers. In a few years there probably will only exist the short range flights versus the long range flights, and not any longer the low cost carriers versus the network carriers. A short range flight is then a commodity at which primarily counts the most advantages price. As relates to the long range flights, however, the spreading of the offers could even become significantly bigger between the price-sensitive economy class and the highest luxury.

And this has which consequences?

This has an effect on the business models of airlines and airports and it is creating great challenges for them. Formerly, one simply offered a terminal for the average client, but in future one has to differentiate much more as to the infrastructure. The connecting link for the price sensitive economy clients on the one hand and the first class and the VIP-clients on the other hand are large and attractive retail shopping areas.

So, there is no way around low cost airlines at the Frankfurt Airport?

There are simply market trends which are not made by ourselves. We can only decide to follow to these developments or not. We have, in the past years, on

average, lost every year around 1 million passengers to the direct German competitor airports in our area, because we did not have an adequate low cost offer. For this reason, we had to open ourselves more to this segment, and this we are doing it with incentives which are transparent and customary in the market.

I do not know any German Airport which does not need incentives. We do need growth. We have a fixed cost business, at which alone the cost block personal expense even at a constant employment goes up every year by over 20 million Euro due to wage increases negotiated with the unions. In order to match with this, I need at Frankfurt annual additional revenues at least of the same size.

So, zero-growth is not possible?

The most elegant way for everybody involved naturally is to generate the additional revenues by growth. This would be a win-win-situation. But when the growth is not sufficient, then the revenues must be increased accordingly. This, neither we do want, nor our customers.

In spite of this, the fees at the airport are again and again a cause for excitement.

Here, one simply has to let the numbers speak. With an annual total expense of around 31 billion Euro at our largest customer, approximately 400 million Euro cash are received by us as airport revenues. This is just about a little more than 1 % of total expenses. When now, Ryanair, according to its own statements, will bring around 1 million passengers to Frankfurt this year, then the company must pay regular fees of 12 million Euro to us. With a discount to this in the first year it is net around 6 million Euro. This incentivising of 6 million Euro will then in the following years be decreased. The initial discount serves the purpose to decrease the charges and the high start-up costs for the new airlines at our airport. As per these numbers you can recognize the order of size and the relativity of the incentives.

But the competition is hard in the industry. Would we completely go without revenues, then the airlines over the longer term would therefore not make more profit, but they would give these savings, because of the competition, and by way of reduced ticket-prices, to the customers, that means passengers. But we would have 700 million Euro less revenues and businesswise we would be finished.

When Fraport is counting on an increased low cost demand at Frankfurt, then the related infrastructures would have to be offered. What does this mean?

As to the Terminal 3, there is a supervisory agency plan design decision. In this document it is precisely

described what must be built and what is allowed to be built. Everything, what we are doing with regard to the changed requirements, must happen within these pre-defined data. Since years, we are planning the Terminal 3 in a first building phase with two departure gate piers. We are shortly before closing the planning for the rough brickwork. The passengers and the airlines are becoming ever more demanding, because of which the new terminal will be built as a very high value project.

And for the new demand for low cost flyers?

We have, with the planning approval of the supervisory agency, already the approval of the construction of a third and a fourth departure gate pier. We do expect that within the context of the expected positive development of the passenger numbers, possibly we will already reach the capacity limit of 68 million passengers at Frankfurt in the next 2 – 3 years. For this reason, there exists the consideration, but not yet a decision, to advance the construction of a third pier for low cost use. Because the Terminal 3 will only go into business in 2023.

What does differentiate this departure gate pier from the other piers?

Because low cost airlines have significantly lower respectively other requirements as to the functionality of a terminal, such a pier could be constructed significantly less complexly and with lower costs – but naturally within the framework of the data stated in the plan design decision by the supervisory agency.

When would you have to decide this and to realize this?

We are also examining other options, but we want to make a decision soon. When the expected passenger numbers will occur, then also this pier must be built significantly sooner than 2023 with a check-in function especially for it. This can be done at relatively reasonable costs because we could save in this expansion building as relates to complexity, especially as regards the technical equipment of the building.

Are these additional costs contained in the so far known budget for the Terminal 3?

No, the so far named and published around 3 billion Euro always related to the Terminal 3 with only two first piers. A third pier would be added to this with around 100 to 200 million Euro, but it would naturally also increase the terminal capacity accordingly. A simple non-complex building can be erected relatively

quickly, it doesn't cost much and it will nevertheless look like very fashionable.

How is your engagement in the Turkish Antalya developing, where you have lately made a loss after a dramatic decrease of the passenger numbers?

Also after the referendum in Turkey our expectation for this year has not been changed. It cannot be excluded that, as relates to the European tourists, this year a further decrease versus the previous year could incur. But the present decrease in March by around 10 % is first of all due to the later beginning of the Easter holidays this year. This first top at the air passenger numbers has this year been deferred to April. The other important tourist group from Russia regularly comes with great numbers only several months later in the main season. We expect, that the traffic volume from Russia after lifting the sanctions and after the return of charter flights will again increase significantly. Overall, we therefore expect an increase by around 3 to around 22 million passengers, and thus we could again write a black zero with our results at Antalya.

Fraport at a glance

Fraport Group Numbers

Sales in million Euro

2015		2599
2016		2586

Group Net Profit in million Euro

2015		297,0
2016		400,3

Passengers in million*

2015		61,0
2016		60,8

Dividend per Share in Euro

2015		1,35
2016		1,50

* Airport Frankfurt

The large Airport Istanbul with a capacity of up to 150 million passengers is approaching completion. What does this mean for the Frankfurt international hub?

We expect, that the airport will take up service as planned. It will naturally and from the beginning take up traffic from the up to now two other airports at Istanbul. This, at the beginning, is only a change of location. But naturally, the new airport is also a competition for the classical European hubs as well as for the airports in the Middle East. But the Turkish airlines which was so successful in the past years, is presently in a difficult situation also because of the geopolitical developments. Many airplanes are grounded, purchases of new airplanes have been temporally stretched.

Against the background of the developments in Turkey, the approval for the acquisition of the 14 Greek airports has come at the right time?

Greece, as a travel target, has developed very well. The airports in 2016 had a passenger increase by 9 %. For us, it was important that we could take over the operations early enough in this year, so that already the Easter businesses could be part of our profit and loss accounts. The Greek destinations are being booked very well because of which we also in this year have a beautiful increase of the passenger numbers of up to 7 %.

Has the money been paid?

The 1,234 billion Euro have been paid. With the plannings for the new construction and the improvement of the airports, which we have taken over, we are at an advanced stage. At the airports Thessaloniki, Korfu, Kefalonia, Kos and Mytilini, we will build completely new terminals. At the other airports we change the construction and improve it. After finishing the works, we will among other things have increased the terminal areas significantly by around one third. This is especially good for the retail shop areas, the quality of being present in the terminals, and for the processes.

Has anything changed at the sums for the capital expenditure?

Originally, we had expected around 330 million Euro. Now, we expect, that it will be a maximum of 400 million Euro. There have always been evaluations as to the improvement or the reconstruction. Now, we have clear results and we are interested in a quick execution because at present, we receive 13 Euro revenue per departing passenger, but after the new



construction and the improvement we can increase to 18,50 Euro.

How did you finance the purchase?

We have chosen the mixture between equity and debt. The equity is around 650 million Euro of which 170 million Euro relates to our partner Copelouzos. The rest is debt-financed. At this, it is about a pure project financing plus credit facilities for the capital expenditures. The interest rates, though, are above the ordinary level in Germany, but for "Greek situations" it is nevertheless a very attractive financing.

In Brazil, lately, you were admitted at two airports as investor, after you had not been successful years ago at two other investment auctions.

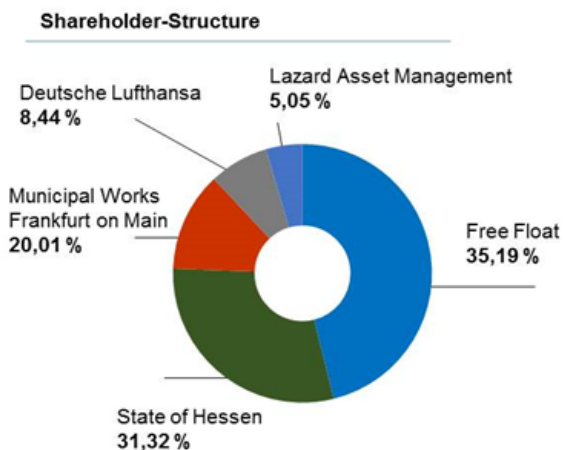
In retrospective, it was shown, that it is sometimes better not to win an investment auction like in 2013. Because it is not decisive for an operator to win an investment bidding, but to make money with airports. At the time – still before the Olympic Games and the World Soccer Championship – the euphoria about Brazil was almost without limits and the number of bidders could hardly be recognisable. At present, we have in the country a significantly difficult economic and political situation, and at the offered four airports there were only 3 bidders, Vinci, Airport Zurich and us, for four airports. And only two airports at the maximum could be taken over by a concessionaire/licence-holder.

The winning-price was favourable?

The auctioning process went very quickly and there have been no such overvalued offers from competitors as like four years ago. The successful bidders had an adequate head-up versus the minimum prices required by the government. For our two concessions Fortaleza and Porto Alegre we are paying 560 million Euro. This suits well to the at present rather modest expectations. But over the longer term nothing has changed as to the high potential of this large and rich of raw materials country.

Other than in 2013, this time no local offerers did participate. Are you now doing this alone?

Here, first of all, we went alone into the race, but we are open for a local partner who for example could add experience as regards the technical construction. But very clearly we will maintain the majority and we will fully consolidate the participations.



Market capitalization
Status July 14, 2017

7.25 billion Euro

Source: Corporation, Thomson Reuters

Was it this now, for once, with your expansion strategy?

If you are looking to our net financial debt, you will see that we have reduced this before the acquisitions increase and Brazil to net 2,35 billion Euro and a gearing of around 60 %. To this, naturally has contributed also the 240 million Euro of damage compensation payments from Manila. Now, naturally before because of the acquisitions, we move quite away towards 3,4 to 3,5 billion Euro net corporate debt. In spite of this, we still have significant leeway for the acquisition of additional airports.

Do you have any concrete plans?

We continue to be very interested in the airport at Sofia, Bulgaria, for which an auction has been started in the last year. But the new elections in Bulgaria in March have deferred this process. It is uncertain whether and when the process will continue. On principle, the airport would be a good fit for us because in Bulgaria we already have the Black Sea airports at Varna and Burgas and we could generate synergies with the Sofia Airport.

At St. Petersburg you have divested shares.

The divestment of shares was a clear opportunity. There came to us the state fund QIA, an investor from Qatar, who made an attractive offer to us for 10,5 % of our participation. With this, we received around 35 million Euro Ebitda result. But we stick to the now still existing 25 % participation because this is a condition for our concession. As a perspective, we remain optimistic for St. Petersburg. In March, there was a passenger plus of 25 % which was a positive surprise.

In a few years there probably will only exist the short range flights versus the long range flights, and not any longer the low cost carriers versus the network carriers.

Then it would have been better not to sell?

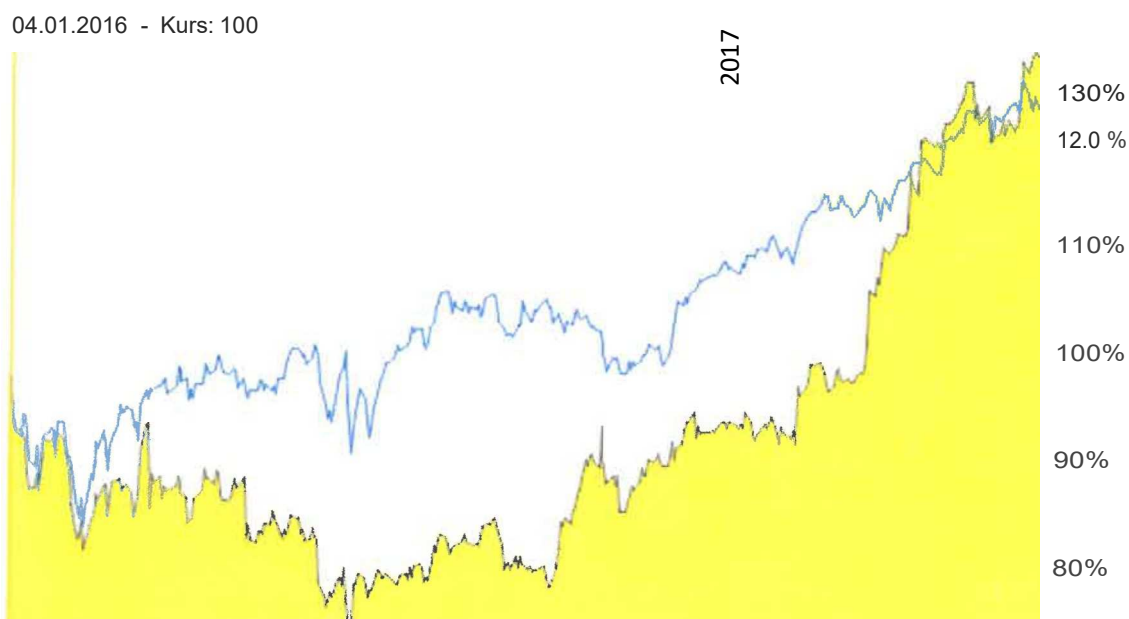
It is part of our business model to further develop participations in airports, and at some time to also realize the value appreciation. Analysts have continued to ask us about the value of minority participations, in order to be able to better evaluate the Fraport share price. In so far we can now say, you do not have to simply believe what we say. But you can now also see, that behind our minority participations there is real value

Does this success of selling shares in your view explain the good development of the Fraport share price in the most recent time?

Fraport AG 78,39 Euro Share Price as of July 14, 2017, German Stock Exchange Xetra

Index Price Chart, Index-base as of January 4, 2016 100

-Upper black line: Fraport AG Share
-Lower blue line: MDAX German 50 Companies Mid Cap Stock Index



No, I do not believe this. More decisive probably is that the analysts basically have a more positive evaluation of the Fraport Group. At this, especially the new evaluation of the traffic chances at the site Frankfurt are playing a role. After the disappointment with the small minus in 2016 as to the passenger numbers, one now recognizes the chance for a significantly higher growth, underlined by the announcements of existing and new airlines.

The interview was made by Lisa Schmelzer and Peter Olsen.

About the person: Professional Optimist

Dr. **Matthias Zieschang** is unperturbed not so easily. Whether it the delay of the take over of the 14 Greek airports, whether its failures at airport auctions, whether it is the permanent dispute with the Philipines about the damage compensation payments requested by Fraport,

or whether it is the dispute with Lufthansa and Co. concerning the incentives offered to new airlines at the Frankfurt Airport – the doctored business theoretician remains relaxed and has the view forward.

Since 2007 the now 56-year-old is responsible for the finances of the airport operator, his job contract has been extended by further 5 years still 2022. Together with CEO Dr. Stefan Schulte the professional optimist so far has also convinced the capital market. The loss of Antalya as a profit contributor in 2016 has been compensated by payments from Manila and by divestment revenues from the partial participation sale of the St. Petersburg Airport more than enough.

From *Börsenzeitung*, Frankfurt am Main, Germany, May3, 2017. Responsible for English translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel



OUR RELATIONSHIP WITH SIEMENS IS VERY GOOD AT THE MOMENT

THE CFO OF OSRAM SAYS, WHY IT HAS BECOME SIMPLER TO EXPLAIN THE STRATEGY AND WHAT HE IS CHANGING IN THE MUNICH GROUP FOR LIGHT-TECHNOLOGY

Interview with Mr. INGO BANK, CFO of OSRAM AG Member of GEFIU, the Association for Chief Financial Officers Germany, from Börsen-Zeitung, Frankfurt am Main, Germany, April 14/15, 2017, article provided by GEFIU, the German IAFEI Member Institute.

Mr. Bank, the running forecast of predecessor Mr. Klaus Patzak for the past business year has been much too pessimistic.

This is very important for me. But precision is not everything. We want to explain to the capital market also relatively simply and clearly, in which direction the corporation is moving, where the chances and risks are.

Positive surprises, however, are often good for the share price.

Deviations should be avoided as much as possible to the up- and downside. Because they are indicating that something in the corporation is not fully understood. We have started to think more in scenarios.

For the objectives 2020 and with your slogan 5-1-5, however, you don't mention margins.

For this we already have margins: 5 to 5.5 billion Euro sales, 0.9 to 1.0 billion Euro Ebitda and 5 Euro earnings per share. But 5-1-5 is more handy in the communication.

Why have you moved the timing, at which OSRAM is producing a business forecast, from summer to autumn?

With several planning parts we can start later in the year: For the volatile part of our business it makes sense, in order to sufficiently define up to date assumptions. So, we de-couple this from that part which can be planned in a simpler way and over a longer term. At the end, the Supervisory Board with a presentation of the budget still has the possibility to adapt the forecast.

What else are you doing differently from you predecessor, who in the meantime works for the Bilfinger Group?

He has left for me a good finance organization. I have focused the team now on accompanying the planning, in order to steer the corporation towards the 5-1-5-targets for 2020.

What do you mean with "accompany"?

The Finance Department together with the Management

has elaborated the budget for the ongoing year and with a view to the year 2020. For this, for example, we are looking at what this means for the individual divisions, where something must happen as regards future growth, the margin and eventually the cost basis. Thereby, we are creating transparency. Then we can see whether we still continue on the road for success. In addition, we are preparing for capital expenditure and we are evaluating the profitability and whether it is matching with our objectives.

Why are the earnings per share such an important number for you?

It shows to the shareholder what he is earning at the end. Especially for the American investors this is very decisive. Still, one third of our share capital is in the hands of Anglo-American shareholders. This we want to regard well. The objective is clear: Until 2020 we want to double the earnings per share from lately 2.50 Euro.

What differentiates your investors from European ones?

American investors are very heavily focused on quarterly numbers, in Europe this is not so marked. Typically, Americans have a strong interest in technology and often they understand it very well.

Is it easier in the USA to explain the strategy of OSRAM?

Not really, but some investors are more interested and have good ideas for us and, for example, are proposing new applications for our products or are proposing corporations for cooperation. These are good advices from which we benefit.

As regards the information of the capital market, OSRAM had to catch up, as the breakdown of the stock price in autumn 2015 has shown as a reaction to the new strategy. How would you have approached this?

It is useless to speculate about the past. I was not a part of it, and therefore I cannot say much about it.

Osram at a glance

Osram Group Numbers*

Sales in million Euro

2014/15	3572
2015/16	3785

Ebita** in million Euro

2014/15	363
2015/16	440

Net Profit in million Euro

2014/15	228
2015/16	532

Operating Cash Flow in million Euro

2014/15	390
2015/16	373

Equity Ratio in percent

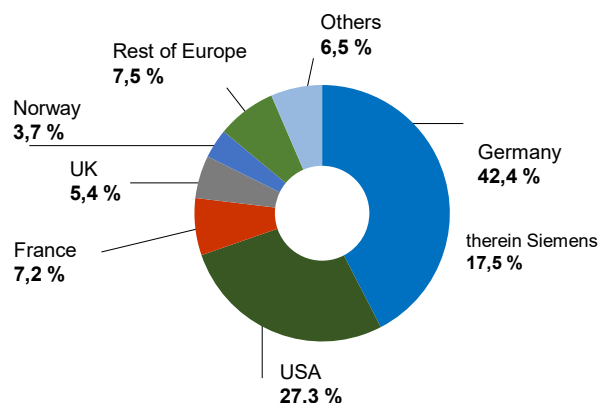
2014/15	52
2015/16	52

* Continued business without Ledvance, business year ends September 30

** Earnings before interest, taxes and goodwill depreciation



Institutional and strategic Shareholders



Status December 31, 2016; institutional Investors are holding over 80 % of share capital

Market capitalization

Status July 14, 2017

7.5 billion Euro

Source: Corporation, Thomson Reuters

**This answer has been expected. So, asking differently:
What do you make better now?**

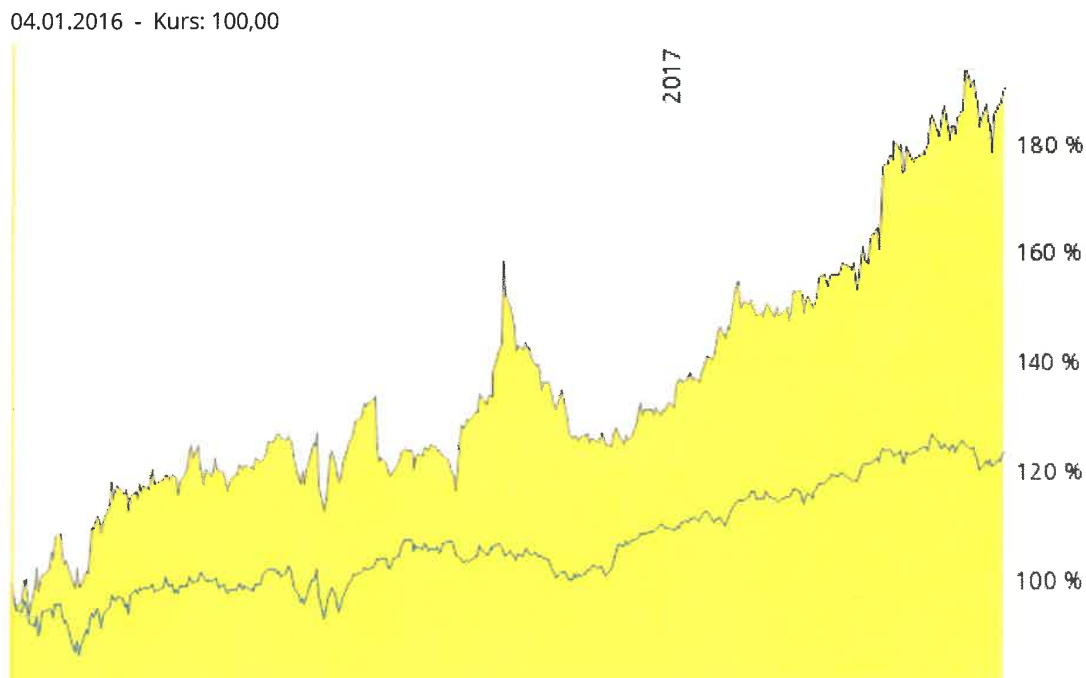
It has become simpler to explain our strategy. Our bulb business Ledvance has been sold. We had a good business year and a good first quarter behind us and the demand for our optical semi-conductors

is presently very strong. Now, it is all about growth. There, the LED chips for the general lightning are offering great chances. With our new LED factory at Kulim in Malaysia, which probably is going to be the largest one in the world, we are creating a good cost basis for the future.

Osram Licht AG 71,70 Euro Share Price as of July 14, 2017, German Stock Exchange Xetra

Index Price Chart, Index-base as of January 4, 2016 = 100

-Upper black line: Osram Licht AG Share
-Lower blue line: MDAX German 50 Companies Mid Cap Stock Index



Especially the announcement of the new factory had sent down the stock price. In the fall of 2015, OSRAM was advertising with a capital expenditure some of 1 billion Euro for the innovation offensive.

This was a misunderstanding. We are building the factory by way of modules, the first one for 370 million Euro. Only when the capacities there will be utilized, the second model will be added – depending on the market development. There is no automatism.

In spite of it, in a recession the factory will probably not be fully utilized. Then the fixed costs would be quite a burden.

Critical voices have drawn parallels to the business with general semi-conductors, especially with storing chips. But there are, though, already big differences. From the beginning, we will produce at Kulim premium products, which had strong demand over the last 15 months, as well as the new chips for the general lightning. This, from the beginning produces a good rise in capacity utilization. But clearly, there is the risk that capacities will not be fully utilized, when it comes to a little downturn.

Is this in the meantime clear to your shareholders?

Yes, they have understood this. OSRAM, by the way, has a changed shareholder-base. Those, who have invested in the restructuring story, have already left. We are now switching over to growth and for this, we have found a few new investors who do want this and who understand our business model.

And what is with Siemens, still largest shareholder?

You must ask Siemens. I refer to the voting results in our general meeting in February. They were very good.

The Board of Management got approval with 99.96 % of the votes. In the year before, however, Siemens has voted against the CEO Olaf Berlien. This was a clear confrontation.

Our relationship to Siemens at the moment is very good.

We are now switching over to growth and for this, we have found a few new investors

OSRAM lately has acquired two smaller corporations. Will this continue?

We have looked around in all our three divisions. Where are we strong, where can we still improve. For our special lightning, to which especially counts the lights for cars, the electronic technology and the software are especially important. Here, we are looking around, also internationally, for acquisition targets or partners.

And the opto semi-conductors?

There, we invest ourselves very much, especially in Malaysia. Acquisitions will be interesting. We could thereby improve our market access. Because for the general lightning, in which we step in, there are different sales channels. In addition, and lately, we have a quiet alliance package from a Japanese producer.

Remains still LSS, the division with solutions and systems.

There, we are especially looking at the service business. This is attractive with higher margins. In the USA we have therefore acquired in February the service provider Manieri- Agraz.

This was a relatively small acquisition. Up to which sales number can you imagine a new acquisition?

It is still possible that we look at an acquisition target corporation with sales up to 500 million Euro. In order to achieve economies of scale, size can play an important role. But at the moment there are no concrete plans.

Financially, you could lift this?

Yes, we have a strong balance sheet. From our financing point of view, acquisitions are therefore less of a challenge. With the sale of Ledvance, our bulb business, we now receive around 500 million Euro – before taxes. We thus have much fire power and the possibility to act. But we do not make the mistake now to buy something only because we can do so.

How are you financing the new factory in Malaysia?

From our cash-flow.

We have much fire power and the possibility to act. But we do not make the mistake now to buy something only because we can do so

OSRAM at the end of the past business year had only 42 million Euro long term corporate debt, and an equity of almost 2.5 billion Euro. From the tax point of view, isn't this unfavorable, also with the view to the low interest rates?

Lately, we have taken up a loan of 200 million Euro from the European Investment Bank for 8 years and had a very good effective interest rate. With this, and when there is a need, we can for example finance the capital expenditures. But it is true: In the past, OSRAM had a very conservative balance sheet-structure.

Why?

My predecessor has made sure that the pension provisions are funded. Presently, we have a funding by 100 %. I am happy that I have this inherited. But our balance sheet structure has certainly leeway.

What does this mean?

For example., we are planning for a different leverage structure. But for this reason, we are not making acquisitions. This we only make, when we regard it as reasonable.

Which debt ratio would be healthy from your point of view?

Presently, we have no leverage effect. But the net financial debt could be the 2 to 3 fold of our Ebitda.

In the year 2020 this would then be up to 3 billion Euro corporate debt?

Yes, this would be possible. But this must not be, because this number itself is not an objective.

The interview was made by **Joachim Herr**.

About the person: From Japan up to into the USA

“I speak German, though, but I think internationally.”: With this Ingo Bank is presenting himself to the shareholders of OSRAM at the annual meeting in February 2017. Since September 2016 the man, born at Dusseldorf in 1968, is CFO of the Munich Group for Light Technology. Before this, he has lived for 20 years in all parts of the world, as he says – in the USA, the Netherlands, Hongkong and Japan. For the OSRAM competitor Philips, he was active in various functions and locations for 18 years.

To think in global and network relationships: This is one of the targets of his work. In the discussions with investors and analysts, for him it’s all about reliability, honesty and transparency. In this area, OSRAM had to improve.

From Börsenzeitung, Frankfurt am Main, Germany, April 14, 2017. Responsible for English translation: GEFIU, the Association of Chief Financial Officers Germany, translator: Helmut Schnabel



COOPERATIVE COMPLIANCE: THE ITALIAN FRAMEWORK

ON MAY 26 2017 THE ITALIAN REGIME ON COOPERATIVE COMPLIANCE WAS FURTHER CLARIFIED BY THE ITALIAN REVENUE AGENCY (IRA OR TAX ADMINISTRATION) BY VIRTUE OF A NEW REGULATION (PROVVEDIMENTO). ANTONELLA DELLA ROVERE AND FEDERICO VINCENTI OF VALENTE ASSOCIATI GEB PARTNERS EXPLAIN.

By ANTONELLA DELLA ROVERE and FEDERICO VINCENTI, Valente Associati GEB Partners (Italian Correspondent), provided by IAFEI International Tax Committee. The article was first published on TP Week.com, <https://www.tpweek.com/articles/>

The Italian framework of cooperative compliance is being built since 2014, when it was envisaged by law as part of a set of measures to establish a more fair, transparent and growth-oriented national tax system. One year later the Italian legislator introduced the regime with a twofold purpose:

- (i) to promote enhanced cooperative relations between tax administrations and taxpayers on the basis of mutual trust; and
- (ii) to prevent tax-related disputes or enhance their effective resolution.

The regime may apply only to taxpayers regarded as cooperative, i.e., committed to identify, assess, manage and monitor risks in relation to violation of tax rules, general principles or the spirit of the Italian tax system (tax risk). Condition precedent is that the respective taxpayers have in place efficient tax risk management systems.

Taxpayers fulfilling certain requirements and being admitted to the regime – following respective application – may enjoy a number of important advantages.

Briefly, they may, indicatively, benefit from:

1. a priori evaluation of tax-risk engendering situations jointly with tax administrations,
2. abbreviated tax ruling procedures,
3. reduced sanctions for materialization of tax risks exhaustively communicated (i.e., final findings of tax law violations),
4. public recording of their cooperative compliance and
5. relief from obligation to provide guarantees in relation to tax refunds.

Today transfer pricing (TP) is a major source of tax risk for multinational companies worldwide: tax authorities target TP matters more and more aggressively; BEPS measures are transforming the TP framework creating fields of uncertainty. Thus,

cooperative compliance seems to offer taxpayers the possibility to manage more effectively the rising risks in the area of TP and beyond. The advantages of cooperative compliance regarding prevention and resolution of disputes with tax authorities should also be duly taken into account.

The concept of cooperative compliance was primarily encountered by the OECD in 2008 in the context of its Study Into the Role of Tax Intermediaries. Seeking to understand the role of tax professionals, the OECD underlined that tax administrations should be open and receptive if they were to improve relations with taxpayers. The Study concluded with recommending that tax administrations pursue cooperative relations with large taxpayers. The idea was further developed in OECD's 2013 report Cooperative Compliance: A Framework, built on the practical experience of several countries that had in the meantime introduced legislation to this effect. The 2013 report expanded the initial recommendation after affirming the relevance of cooperative tax relations to increase tax compliance.

In view of the above, the recent Regulation enhances the Italian cooperative compliance framework by clarifying some practical aspects thereof. In particular, clarifications are made on three main areas: (i) obligations of tax administrations and taxpayers in the context of cooperative relations established under the regime, (ii) procedures taking place in the context of such relations, and (iii) reasons for dis-application of the regime with respect to specific taxpayer. It is also provided that competent authority at least for the first phase of application of the regime shall be the Cooperative Compliance Office of the IRA.

More specifically, the Regulation begins with specifying and analyzing the principles to underpin the behavior of the parties to the cooperative tax relations established under the regime.

As regards IRA, its approach towards taxpayers should be oriented towards cooperation, fairness, transparency and legal certainty. Such principles imply that tax administration must seek to understand taxpayers' business motives, be impartial, open and responsive. It must also act with a view to enhancing certainty in tax matters, i.e., provide prompt answers to taxpayers' queries and ensure that the positions expressed are consistent and compatible with objective and reasonable criteria and the principle of proportionality. Such positions should also be

regularly published to allow taxpayers to adopt their behavior to IRA's reasonable expectations. Most importantly, the new Regulation includes detailed provisions as regards taxpayers' right to privacy and data protection. Taxpayers' information obtained in relation to the regime (including application for admission) shall be treated as professional secret and used only for the purpose of provision, irrespective of taxpayer's final admission to/subsequent exclusion from the regime.

At the other end of the spectrum, taxpayers should be cooperative and transparent in their relations with tax administrations. Such principles should be reflected in taxpayers' corporate governance mechanisms as well as in the general corporate culture. In detail, taxpayers' eligibility to apply for the regime depends on the demonstration of an efficient tax risk management system. During the period of application of the regime to specific taxpayer, such system must remain in place, be regularly updated to take into account new risks and be amended in line with any indications of the IRA.

Furthermore, cooperation and transparency demand that taxpayers supply exhaustive information on the tax risks identified as relevant to each tax year of application of the regime. Equally, they are expected to inform IRA in full detail on (i) any situations that might engender important tax risks and (ii) any transactions that could be perceived as constituting aggressive tax planning. Finally, cooperative taxpayers are expected to implement corporate governance strategies driven by the values of honesty, fairness and respect of tax laws. Such values should also be incorporated in writing, e.g. in ethical codes, codes of conduct, behavioral guidelines.

Following specification of the above obligations, the Regulation details certain procedures taking place in the context of the regime, from admission to the closing of the tax year, and their interaction with other tax procedures.

Major weight is attached to the establishment of constant dialogue between IRA and cooperative taxpayers. To this end, for each cooperative taxpayer a delegated team is formed by authorized representatives of both parties to the cooperative relation to lead the application of the regime. The Regulation refers also to (i) an opening meeting, for the joint specification of materiality thresholds in relation to tax risks to be communicated by the

taxpayer as well as to (ii) an annual closing meeting (at the end of each tax year) for the purpose of review. With respect to IRA's positions on the taxpayer's specific circumstances examined during application of the regime, they shall in principle be incorporated in writing in reasoned opinions or equivalent documents.

Where however such circumstances relate to issues of strategic importance for the taxpayer a binding Cooperative Compliance Agreement should be concluded by both parties to the relation. In any case, it is specified that for questions within the scope of advance pricing agreements (APAs), the taxpayer may also activate the respective specific procedure.

Further on, it is clarified that admission to the regime is no panacea but any specific taxpayer might lose the benefits therefrom in certain cases. Specifically, IRA is

entitled to revoke an established cooperative relation, where the taxpayer no more fulfills the requirements for admission or violates his obligations thereunder.

It is worth noting that the regime is only in its first phase of application which shall last until the end of 2019; hence, in principle, it is only available to large taxpayers, i.e. enterprises with annual turnover equal to at least € 10 billion. It follows that during such first phase, taxpayers fulfilling this condition and admitted to the regime that subsequently fail to realize the above turnover for 3 consecutive tax years shall be excluded therefrom.

There is no question that cooperative compliance is the sole way forward to construct fair and efficient tax systems. The Italian regime seems very promising. Hopefully, Italian practice will prove up to it.



FARSEEING NEXT DECADE OF SUCCESS

By CARLOS AMTMANN ITUARTE, President of National Technical Competitiveness Committee at IMEF, Instituto Mexicano de Ejecutivos de Finanzas, the Mexican IAFEI Member Institute

Country competitiveness comparisons have an impact throughout the world. Particularly since the annual report published by the World Economic Forum Organization (WEF) where their weaknesses and strengths are shown. That report called The Competitiveness Index groups country performance indicators into twelve pillars. In Mexico, several private institutions have assumed a compromise with this benchmarking effort, among them is IMEF (Institute of Mexican Financial Executives), which at the beginning of this century founded a National Technical Committee with Financial Executive Officers in order to consider the importance of Competitiveness consequences within their business decisions.

In order to inform and compare variables that define international economic competitiveness, Charles Schwab, founded WEF in 1971, year in which he published his book titled *Moderne Unternehmensführung im Maschinenbau* (Modern Enterprise Management in Machine Building). That same year, the world was undertaking a floating exchange currency rate system, leaving behind the fixed gold standard.

Nevertheless, it is not the purpose of this article to tell the story of industrial growth, energy demand expansion, oil reserves and monetary flows to and from the Middle East, which in turn invested their

surplus cash flow in European and North American banks in the sixties and seventies of the twentieth century. But that change in monetary standard and flows, allowed developing countries to receive financial support to expand their infrastructure and continue institutionalizing their countries in those years.

Related to these changing times, we find the first phase within The Competitiveness Index called Basic requirements subindex (71) that shows four pillars such as: Pillar 1. Institutions (116); Pillar 2. Infrastructure (57); Pillar 3. Macroeconomic environment (51); Pillar 4. Health and primary education (74). Inside parentheses appears México's place among 138 countries rated in the 2016-2017 WEF Global Competitiveness Index.

In the seventies, while oil prices rose, the surge of inflation was not quite understood because as the fixed currency standard was overturned, developed countries knew that monetary growth could be issued at a similar rate as the economy grew without causing inflation. Meanwhile, developing countries felt the need to grow at a higher pace in order to overcome poverty, so they urged their state controlled Central Banks to issue money at a higher pace and income served as source of credit, to finance not only national infrastructure but current expenditure. Not science, not machine building, but construction, which indeed was widely needed.

Government Institutions until now still indulge in reminiscence from those times gone. Excessive spending and indebtedness sent inflation up to an annual 157% in 1985, thus government was unable to maintain that level of spending when oil prices fell, a situation that led to the nationalization of the banking system. That in turn, worsened growth and exacerbated the poverty problem. Nevertheless Mexican society found a way out of that crisis.

That decade missed an opportunity to raise educational levels and business entrepreneurship. Maintaining a huge bureaucratic apparatus with exceptional retirement benefits for their own. That might explain that our institutions as a whole still qualify as 116 among 138. Taking this gap into account, IMEF's interest in accelerating progress is reflected in its 18 National Technical Committees being the Anticorruption committee a specific effort to contribute to this task. That takes us into Competitiveness second phase called Efficiency enhancers subindex (45) composed by another four

pillars: Pillar 5. Higher education and training (80); Pillar 6. Goods market efficiency (70); Pillar 7. Labor market efficiency (105); Pillar 8. Financial market development (35); Pillar 9. Technological readiness and Pillar 10. Market size (11).

WEF states that countries convey from factor driven stages in which economic development depends on selling raw materials, towards a second stage which is efficiency driven and then a third stage. In this sense, Mexico is ranked in 35th place in Financial market development and 51 in Macroeconomic environment, while Market Size is in 11 and Labor market efficiency in 105.

After a massive downsizing of government investments in business enterprises that turned inefficient due to economic instability and lack of management capabilities, its participation in national gross domestic product returned to 20%-22% rather than its top share which surpassed 50%. It certainly involved risks, it required a heavy investment in banks, in order to capitalize the financial system, but in turn government opted out from being entrepreneur. That was a first decade of success, the nineties.

Now at different scenarios, IMEF members as well as the institution have contributed with government authorities to understand the importance of advancing in such matters as Investing, Labor Productivity and Innovation.

Our market by size could be classified in stage three where 34 Innovation Driven economies compete, but market size like other global variables need closer analysis with specific countries appraisals.

The Organization for Economic Cooperation and Development (OECD) had an initiative to compare country productivity evolution. Dale Jorgensen contributed by restating Productivity formula, as KLEMS, which compares real output growth with increases in real cost growth in capital cost (K), labor (L), energy (E) and materials consumption (M) and services cost growth (S), if the difference between Output growth minus KLEMS factors consumption increase is positive, it means that productivity grew. Numeric results explain several evolutions during a period of 25 years, which involve the second and third success decades. First of all, our statistical institute INEGI, was congratulated for its management of the project, that is, because the results exposed evolution of productivity in 67 different economic

activities. Although productivity as a whole has fallen by 0.23 basis points, there are 16 economic activities showing productivity growth. Four of them with significant numbers: Telecommunications (4.19), Massive media management (2.71), Courier and parcel delivery (1.99) which are innovative industries of recent arrival. Other traditional industries included Mining (0.34), Financing activities (1.54) and Vehicle manufacturing (0.84). But then, industries whose growth has exploded because of North American Free Trade Agreement (NAFTA) such as electronic devices manufacturing have marginal positive numbers anchored in transfer pricing regulations.

Some of those results are highly conclusive. For example: electronic equipment manufacturing has grown at an average of 12.44% per year, while its capital consumption did at a rate of 0.67%, labor at a rate of 0.35% and materials at a pace of 8.82% each year, showing that revenues surged in market growth as sales went into materials, not into labor retribution. Within those numbers an explanation arises, research and development in electronic devices is collected by means of paying for the imported components, manufactured abroad, that are to be assembled domestically.

But when data is analyzed otherwise, several conclusions can be exposed. One of them stems from constructing a cumulative growth indicator, settling the index at number 1 in year 1991, and making it grow compounded yearly at the real growth rate reported for each KLEMS factor at each economic activity. What is to be found out could be the comparative growth rate of Production Output versus growth in Capital Investment, Labor Retribution or Materials Consumption.

In the economy as a whole, results show production output reaching a 2.056 factor, capital growth at 1.390, labor growth is 1.093 and productivity as mentioned before reduced in this case to 0.918. Imagine a linear graphic in which capital growth line has an inclination of 39 degrees and labor of 9.3 degrees. That pattern repeats itself in most industries.

Taking an average point of view another graph can be constructed in which the X axis shows average growth in capital and Y axis average growth in labor retribution. At the right extreme, financial activities settle the record with a 3.84 annual percent growth while labor in this industry grew 0.52%. Using

this graph to identify corresponding point for 26 industries and inserting a linear adjustment line, its equation shows that for each unit of capital growth, labor grew 0.114.

Of course opening markets to global commerce has been a success. Leveling pillar 8, Financial market development (35) sets Mexico at the brink of the 34 countries that compete among the Innovation driven economies stage, but then, there is the Labor market efficiency pillar that reports place 105 that diminishes place number 11 in market size.

Why is that so? Because of income distribution. Assembling components labor cannot be rewarded as inventing and manufacturing technological devices are. Machine manufacturing also, both involve innovation, which is the clue to productivity based on higher education; thus this pillar still qualifies in number 80. Another source of little or even less value added jobs are informal market activities, such as street commerce or standing food services. They are simple jobs that grew fast while financial crisis arose but that must be overcome by newer generations of business. These informal activities still account for 59% of Mexico's labor force.

The next decade brought several root accomplishments. A new labor law, which emphasizes Productivity and dignified salaries was approved in 2012. This regulation includes the design of a National Productivity Council in which four parties participate: Government, Academy, Unions and Business representatives. It started to work with quarterly conclusive meetings facing budget restrictions in every single resolution -and there have been several-, with no financial backing, just collaboration agreements.

Another important step forward is to be singled out. Ruling PRI party at the beginning of its 2012-2018 term accomplished a leapfrog initiative setting a Pact for Mexico, with the two other leading parties PAN and PRD that turned out in several structural industrial reforms in order to get rid of antique mindsets. One of the so called profound reforms that has -up to now- obtained important investments is the Energy Reform, allowing exploration and productive capabilities in association of private and public investors with foreign investments. Other reforms include the education system and the telecommunication in order to melt down monopolistic privileges acquired decades before, as this industry was privatized.

Something to be highlighted is the so called Special Economic Zones, initiative that is under way assigning federal land spaces, four or five in total, among the less developed southern states with special tax treatment designed to create industrial parks.

In recent years an Institute to boost Entrepreneurial startups (INADEM) has been performing in alliance with Academic and Science institutions to foster creation of innovative enterprises along with an old Institute for Science and Technology which has received budget resources that amount up to 0.166% of National Gross Product (GNP). Twenty six thousand academic researchers were benefited with these funds and have been rewarded for their publications. On the other hand, business investment in research and development (R&D) accomplishes another 0.2% of GNP. This includes state government owned oil company Pemex. The rest of national investment in R&D is provided by federal funds assigned to public universities. Developed countries invest far above 2% of GNP in R&D, thus Mexico requires a significant change of pace.

It is well known in Mexico that publication of research results is too risky, exposes disclosure of possible patent opportunities by an unforeseen researcher, while not producing industrial alliances for the scientist creating an issue that requires a substantial overhaul. For example, this year, called dual year Mexico – Germany has shown in diverse instances that a University in Germany gets an increase in Government funding if its academic body gets innovations into industrial production, using royalty paid to the researcher as an evidence of his or her success.

Cluster collaboration has been another learning contribution in Mexico gained from opening industrial

markets. Institutions such as the Tecnológico de Monterrey and INEGI in collaboration with INADEM, have spent significant research resources since the creation of the so called Strategic Observatory and Mexico's Cluster Mapping site, whose mission is to detect possible cluster formations detected and publicized quoting product opportunities within specific macro-tendencies. With INEGI's detailed statistical information by economic sector or even with microdata by enterprise, researchers can access freely those services to study and detect which category of products have substantial muscle in a region by means of its Economic weight, Concentration Index, pondering Production Output, Occupied labor and Value added.

This same institute has published and promoted a guide to get regional agreements within potential regional members that supports cluster formation. This initiative can be farsighted as the right spot to assign a new kind of collaborative or dual budget spending. This could mean, having federal budget assigned to pay academic researchers that work inside companies looking for innovations and cluster formation can be successfully worked out.

Mexico's place in 2016-2017 WEF competitiveness index is 51. That is this new development effort in which machine building, material handling through advanced communication and transportation infrastructure and delivering value added with performance rewards for labor accomplishments will play a substantial role to get into a better rank. IMEF is interested in supporting these initiatives that are built on solid insights, thus the path for a fourth decade of success is being laid out at a speedy pace.



CATALONIA, EUROPE'S INVESTMENT GATEWAY

WITH THE SAME NUMBER OF INHABITANTS AS FINLAND OR DENMARK AND AN AREA SIMILAR TO THE NETHERLANDS OR BELGIUM, CATALONIA HAS ESTABLISHED ITSELF AS ONE OF EUROPE'S MOST SIGNIFICANT STRATEGIC HUBS. WITH OVER 7,000 MULTINATIONALS OPERATING IN CATALONIA, IT HAS BEEN RECOGNISED AS THE BEST SOUTHERN EUROPEAN REGION FOR INVESTMENTS IN 2017.

By JOAN ROMERO, CEO Catalonia Trade & Investment, article provided by DFCG, the French IAFEI Member Institute

Catalonia is one of Southern Europe's driving forces and one of the main economic hubs in the Mediterranean. The Catalan economy has become consolidated in global value chains and it has also made its name as a strategic investment bridge into Europe. Figures back this up: Catalonia closed 2016 with record figures of foreign investment. According to data from the Spanish Ministry of Economy, Catalonia earned 5,051.5 million euros in foreign investment, 2.3% over the previous year, which had already shown an historical maximum, with 4,936.4 million euros.

The Government of Catalonia works hard to help foreign companies interested in investing in Catalonia. From Catalonia Trade & Investment, the Catalan government agency responsible for promoting and attracting foreign investment and with more than 30 years of experience

behind us, we accompany companies throughout the process of setting up and expansion in Catalonia through specialized one-stop-shop services. In this regard, Catalonia Trade & Investment last year materialized 68 foreign investment projects totalling 352 million euros, also a record figure, half of which were Greenfield investments.

Companies committed to Catalonia

Large companies like Amazon or Nestlé have, over the last few weeks, announced major investments in Catalonia. The US company has opted for Catalonia as a strategic hub in the logistics sector in Europe, as evidenced by the five major investments announced last year and that will turn Catalonia into its gateway to Europe. For its part, Nestlé has just announced a new investment for its soluble coffee plant in Girona,

amounting to 37 million euros, that will consolidate the Catalan plant as the worldwide centre of reference for the Swiss multinational in the production of soluble coffee.

Furthermore, the Hong Kong company Thunder Power has announced that it will invest 80 million euros to open an R&D centre in Catalonia in the field of electric vehicles. Lidl will open a new logistics centre near Barcelona and the French firm Criteo has turned his office in Barcelona into the company's most important European hub after that of Paris. These are just some examples that demonstrate how Catalonia has been able to position itself internationally as an innovative region, with a solid industrial base and inclination, and above all, connected to the world.

These companies are just some of the 7,086 foreign companies established in Catalonia, which currently are behind 18% of the country's employment, 45.4% of exports and almost 30% of turnover. These figures show that multinationals are key players in the Catalan economy, an economy open to the world and open to business. Geographically, Germany, France and the United States are the three main countries behind multinational companies here.

Why choose Catalonia?

The British Financial Times Group recognizes Catalonia as the best Southern European Region of the Future in its latest report on the most attractive European locations for future investments. What favourable conditions do multinationals find when it comes to choosing Catalonia to locate their businesses?

When multinationals from all over the world arrive in Catalonia, they find a region of 7.5 million inhabitants - such as Finland or Denmark - with a land area similar to that of the Netherlands and Belgium and with an industrial concentration in the economy above the European average. Catalonia accounts for 16% of the Spanish population but generates up to 20% of its GDP, 23% of its industry, 25% of exports and 35% of regular exporting companies in all Spain.

Multinationals find a competitive ecosystem in Catalonia with all the assets that will allow them to grow and successfully continue their internationalization processes. The Catalan economy is markedly industrial, highly diversified in sectorial terms and with innovation and internationalization as pillars for growth. Precisely, its industrial muscle and powerful ICT sector put Catalonia in a privileged position to lead the fourth industrial revolution in Europe.

Industry represents 20% of the Catalan economy – higher

than the European average – and its commitment to ICT has materialised into, among other things, becoming the worldwide mobile capital thanks to hosting and organising the Mobile World Congress each year, the promotion of initiatives such as the 3D Printing Hub – an international meeting point between suppliers of this technology and companies from all over the world interested in initiating projects in the 3D printing field, or the Catalonia Living Lab – the pioneer testing ground in Europe in the field of autonomous and connected vehicles.

Beyond its commitment to the development of industry 4.0, Catalonia has many other attractions, such as its privileged strategic location. It is clear that companies must move, and look for new countries where they can grow and create new international trade flows. It is also clear that the economies of the 21st century must be integrated in this global context. In this sense, Barcelona offers full-modal transport integration (sea, airport, motorways, railways) within 12-kilometre radius, each with global connectivity, making Catalonia an exceptional gateway to Europe and a unique bridge to North Africa and Latin America.

Barcelona airport shows double digit growth rates annually, and is today one of the most important airports in Europe. It offers more than 200 destinations around the world operated by 100 different airlines carrying more than 44 million passengers per year. Airlines like Norwegian are increasing their commitment to the airport, with new facilities and new direct connections to Los Angeles, San Francisco, New York and Miami. Korean Air has also announced direct flights between Barcelona and Seoul.

A byword for innovation, research and technology

The Catalan public and private sector have both made the promotion of innovation a top priority. Catalonia combines a series of highly attractive factors that make it a great location for R&D activities and that are hard to find in other areas of the world. In this sense, business R&D figures are growing year after year and Catalonia is producing 1% of the world's scientific output, with 0.11% of the world's population.

For foreign companies, Catalonia offers access to technology centres and world-class scientific facilities, such as the Alba Synchrotron, the first particle accelerator in southern Europe, the Mare Nostrum supercomputer, Spain's premium supercomputer and one Europe's foremost, as well as IDIADA, specialized in providing design, engineering, testing and homologation services to the automotive industry worldwide.



In the field of scientific and technological production, two aspects are worth mentioning: the Biocat Foundation, whose aim is to create a strong research environment, an active transfer of knowledge and a dynamic business ecosystem in the field of biomedicine and biotechnology, and the Eurocat Technology Centre, which is the result of the union of five advanced technological centres in Catalonia and promotes business competitiveness acting as a bridge between research, i.e. knowledge generation, and companies, i.e. value generation.

A magnet for talent

One of the clear pillars of Catalonia is its indisputable ability to attract talent, which, coupled with powerful local talent, makes investing in Catalonia very attractive. Excellence in the field of education is demonstrated by the fact that Barcelona is home to some of the most prestigious business schools in the world such as IESE, ESADE or EADA, according to various international rankings; also noteworthy is the fact that it also has 3 of the 50 best universities in the world under 50 years old, according to the QS 2017 World University Rankings, and that The Times Higher Education has ranked the Catalan university system as the 3rd best in Europe.

In total, the 12 Catalan universities currently offer 600 degrees to 220,000 students.

Catalonia is a magnet for young professionals and researchers from all over Europe. And also for the 23,000 foreign students who come every year to the universities here. All these factors create a Catalonia open to the world and with a strong tradition of accepting newcomers that builds an environment with great cultural diversity and an inclusive, modern and cosmopolitan mentality. What's more, Catalonia has all the ingredients to become a meeting point for international businesses and is the best setting for shared service centres that can offer their services in thirty different languages.

A European hub for tech startups

Catalonia's dynamic economy is clearly seen in the growing start-up ecosystem located mainly in the city of Barcelona. According to the Barcelona & Catalonia Startup Hub directory, Catalonia has more than 1,150 startups, the vast majority with a technology base. Several reputable international rankings place Barcelona among the top 5 European cities in terms of startups and digital entrepreneurship. These classifications consider the presence of local and international incubators and accelerators, access to venture capital funds and business angels, the ability to attract local and international talent, the presence of international fairs such as the Mobile World Congress and, also, a highly appealing quality of life.

It is a buoyant and growing ecosystem that attracts investors and offers business opportunities in different industries, especially in the ICT field where Catalonia has 13,000 companies, employing more than 84,000 workers, a turnover of 14,000 million euros and investing 200 million euros per year in R&D. This guarantees top level suppliers and providers for foreign companies interested in investing in Catalonia.

All these reasons mean Catalonia has the strengths to keep on being one of Southern Europe's main players. From the Government of Catalonia, through Catalonia Trade & Investment, we urge and encourage all companies in search of a place where they can grow, expand and integrate into international trade flows to come to Catalonia, a land where everything is possible, and with all the guarantees to build and expand any business.



SHARED SERVICES CENTER

WHY **BARCELONA** IS A FIRST CLASS OPTION FOR A SHARED SERVICE CENTER

By GEOFFROY DE BEAUCORPS, Finance Director Continental Europe at PageGroup, article provided by DFCG, the French IAFEI Member Institute

When we first opened our Shared Services Centre, SSC, in November 2014, I was often asked 'why Barcelona'?

The answer begins with what we needed. We were committed to centralizing our operations and fully understood the benefits that creating an SSC would bring. Streamlining our services across Europe would deliver efficiency and cost savings. It was the right thing to do, and an exciting initiative. The big question was where?

The truth is, despite its renowned sun, sea and

sand, Barcelona wasn't the first location we had in mind. We considered several other options including attractive cities in Poland and Portugal.

As a company with a global footprint, operating in more than 13 countries in Europe, you might assume we had an advantage in selecting a location, but that's not necessarily the case. Sure, we have developed extensive knowledge and expertise in recruiting talent for businesses in European cities. But a project on this scale, involving providing support for countries with different systems, languages, operating models and more, was never going to be easy. We were seeking a hub that was strategically located, a key magnet

for talent and an attractive place to work. It had to be somewhere that resonated with our PageGroup values and culture. We had to dig deep!

After several consultations, in-depth evaluations supported by an external consultant, and visits to multiple locations, we weighed up the pros and cons of all the possibilities. The management board carefully considered every angle and we were increasingly pulled by the attractiveness of Barcelona as a city.

Barcelona has a growing international and local talent pool – young, adventurous, skilled professionals with multi-lingual skills. This was so important for us, with diversity at work as a key part of our employer value proposition. Salaries were competitive and Barcelona's location by the Mediterranean Sea means employees are never far from the beach or the mountains – a benefit that money can't buy. Essentially, in Barcelona, we were more likely to attract and retain talent and the city really embodied what we were looking for. Our choice was made easier by the Government of Catalunya, which actively supports companies who are establishing businesses in the region. It just had to be Barcelona.

And my personal view? Well I'm so committed to what we have built here, that I relocated to Barcelona from our office in Geneva. This meant uprooting my family to a new country, where we've learnt a new language, bonded with locals and explored the extensive landscape that Catalunya has to offer. Barcelona is a city where people tend to feel at home rather quickly. It has a great sense of ease, rich cultural traditions, events and expat communities – all of which are great for helping us retain our talent. During our transformation, we've relocated people from PageGroup offices across Europe, and the city has meant that more often than not, very little persuasion is needed.



Our vision for our SSC was a multicultural workforce. We wanted to offer a great office location with a well-supported infrastructure. On average, we have about 200 visitors a month passing through our Barcelona SSC doors, with senior leadership Executive Board meetings, training sessions with colleagues from across Europe, and visits from colleagues from other regions of the world. These past few months have been particularly busy with guests who are really keen to visit. They love the atmosphere we've created and what we represent as a business. A well connected international airport as close as a 10 minutes taxi ride doesn't hurt either!

I'm now proud to work with almost 300 people at our Barcelona SSC, who represent over 20 nationalities and a vast range of skills. The sheer growth and diversity is a testament to the success of our business and I am excited about what we'll continue to achieve going forward.



BENEFITS AND CHALLENGES FROM GLOBALISATION

Remarks by Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, at the Bombay Stock Exchange, Mumbai, India, 11 May 2017

Thanks, Ashish, and thanks to the U.S.-India Business Council, the Confederation of Indian Industry, and the Bombay Stock Exchange for organizing this event. As always, what I have to say reflects my views and not necessarily those of the Federal Open Market Committee or the Federal Reserve System.¹

It is a pleasure to have the opportunity today to talk about the issue of globalization. Although the debate about the benefits and challenges of globalization

is not new, it has recently come into sharper focus. This debate is important to all of us, and I think it is particularly relevant to India given its growing role in the global economy.

Globalization means different things to different people. In my remarks today, I will focus on the role of globalization as a force for international economic integration and economic development.

I will highlight three themes:

First, the important role that trade plays in promoting higher standards of living globally.

¹ MaryAmiti, John Clark, Gerard Dages, Matthew Higgins, Tom Klitgaard and Joseph Tracy assisted in preparing these remarks

Second, how changes in trade can create challenges for industries that become less competitive. We have not adequately considered and remedied the very large costs this can impose on certain communities and households.

Third, the answer to those challenges is not greater protectionism. Instead, we need to provide greater support to displaced workers so they can obtain the skills needed to find new well-paying jobs. We need to do better in preparing workers to deal with the challenges of globalization and technological change.

These issues are important to me as a central banker, as they affect the long-term health and productivity of the economy, and the economic opportunities available to our people.

The debate around globalization, particularly in advanced economies, reflects a range of factors. Undoubtedly, the global financial crisis and subsequent slow recovery have been significant. But, just as important have been longer-term trends, such as growing income inequality, the loss of middle-income jobs, and the rise of large emerging market economies such as China and India.

Although the debate about globalization is not new, I believe we are at a particularly important juncture. If support for liberalized trade and an integrated global economy were to suffer a significant setback, the consequence could be slower economic growth and lower living standards around the world.

While considerable effort has gone into liberalizing trade and developing the existing set of trade agreements, that does not mean they cannot be improved upon. I have no doubt some trade agreements could be enhanced or updated. Some may not adequately address recent changes in the global economy—such as the rise of digital trade—and may need to be refreshed. And, important trade barriers still remain and should be addressed. In particular, from a U.S. perspective, the access of U.S. firms to some foreign markets and the protection of intellectual property rights are issues that deserve close attention. But, in addressing these issues, we should take care to preserve the vital benefits of trade to higher standards of living in both advanced and emerging market economies. Our focus should be on further strengthening an open trade regime, and, as appropriate, amending and improving these agreements.

The Pace of Globalization

To begin, let me briefly describe the pace of globalization as a reminder of what is at stake. Global economic integration has increased dramatically in recent decades. Trade, for example, has grown from nearly 40 percent of global GDP in 1990 to 57 percent in 2015. Over the same period, the stock of foreign direct investment has increased from roughly 10 percent of global GDP to 34 percent. Ultimately, economies have become more integrated and interdependent.²

This rapid growth in trade reflects falling trade barriers, declining transport costs, and improved information and communication technology. These trends have enabled the development of complex global supply chains that allow companies to manage their production more efficiently.

Emerging market economies now make up a much larger share of global trade, the global economy and global growth. As an illustration, emerging market economies have accounted for 70 percent of global output growth since the crisis—double their share from two decades ago.³

This growth has provided much-needed support to world economic activity, as advanced economies have recovered slowly from the crisis.

Rising economic integration is also very evident when we examine the trade relationship between India and the United States. Bilateral trade flows have risen tenfold, from \$11 billion in 1995 to almost \$110 billion in 2015. In particular, half of U.S. imports of computer services are now sourced from India. In 2015, the stock of bilateral foreign direct investment in both countries was \$37 billion, up from \$4 billion in 2002.⁴ The potential for further increases has been reinforced by the liberalization measures India announced last year to encourage greater foreign direct investment.

² Figures from UN World Investment Report, IMF World Economic Outlook Database, World Bank World Development Indicators

³ IMF World Economic Outlook, April 2017, in market exchange rate terms

⁴ Figures from Office of the U.S. Trade Representative, UN World Investment Report

Benefits of Open Trade

Increased trade, through its longer-term impact on productivity, has been a key contributor to global growth and prosperity since the Second World War. Openness to trade brings many benefits to the supply side of the economy. These include: larger markets, greater specialization opportunities, and the increased ability to exploit economies of scale and scope; faster transmission of technology and innovation; and greater competitive pressure on domestic firms to increase their productivity.

Collectively, these forces lead to a more efficient allocation of a country's scarce resources—one that is more closely aligned to its international comparative advantage.

As a consequence, consumers can benefit from lower prices, higher real incomes, and greater variety and quality of goods and services. Increased openness may also reduce wasteful rent-seeking behavior on the part of protected industries and the related costs of corruption.

These benefits from open trade are very evident in India. Academic research has found substantial gains for India following its dramatic trade reforms in the 1990s, which benefited consumers via lower prices and firms via higher markups. These higher profit margins spurred innovation and provided funds for the development of new products. Looking ahead, the upcoming implementation of the goods and services tax in India—which will create a common market internally—is expected to provide many of the same benefits as trade liberalization does internationally.

Openness to trade has certainly played a large role in the economic ascent of Asia. Following the rise of Japan, Korea, Taiwan and others, fast growth in China and India has lifted hundreds of millions of people out of extreme poverty—an unprecedented feat in human history.

The benefits of economic integration and other reforms are exemplified in India's higher growth rate since the introduction of market reforms in 1991. Growth has averaged 6.5 percent annually in the post-reform period, compared to about 4 percent annually over the prior 40 years. Indeed, India is the fastest-growing major economy in the world today.

Reflecting these gains, a number of emerging market countries have been strong supporters of open trade, a sign of how much the world has changed in recent years.

A few examples can help to illustrate some of the benefits of globalization. India's green revolution—which helped to greatly increase its agricultural productivity and food security—was facilitated by U.S. technology and scientists working with their Indian counterparts. Similarly, as is well known, Indian engineers and entrepreneurs have played a key role in the technology sector's tremendous achievements in recent decades and now lead some of America's largest companies, including Google and Microsoft. This success, in turn, has had important benefits for India as well, including increased foreign investment flows and employment opportunities that have helped develop a vibrant information technology ecosystem.

But, increased openness to trade is not a panacea in and of itself. Actual benefits depend on a range of other critical factors, including macroeconomic policy, the business and regulatory environment, the legal regime, the quality of infrastructure, and the quality of public services, including education. While the gains from a liberalized trade regime are not guaranteed, the alternative of trying to achieve a high standard of living by following a policy of economic isolationism will fail. Trade has played a key role in nearly all of the high-growth success stories since the middle of the last century.

Challenges of Open Trade

It is important to recognize that while trade and international integration tend to increase the overall economic pie, the distribution of the larger pie may be very uneven. In fact, slices for individual groups may shrink. Some workers—particularly those in industries that are less able to compete and whose skills have become less relevant—can be hurt and find it difficult to adjust. This often requires individuals to change industries and to relocate to different regions. So, while trade is almost always a win for a country's economy, not everyone within that economy will be a winner. This is especially the case where there are no policies to cushion the negative consequences of trade and to facilitate adjustment.

Effects are also country- and industry-specific, and depend on initial endowments and conditions. Low-

income workers in emerging markets, for example, may find it more difficult to adapt given weaker safety nets and less financial resources available to deal with adverse economic shocks. The bigger the adjustment process, the more the gains from trade will tend to be eroded.

While the rise in the skill premium from trade liberalization has been well established for both developed and developing countries, determining the aggregate impact of trade on jobs has been more challenging. To date, the evidence has been mixed. We need further research in this area to determine with more confidence a reasonable range of estimates for these employment effects. Although evidence on the extent to which jobs have been lost due to global trade is inconclusive, job losses that are attributed to trade tend to be viewed differently. That is, they are seen as having been “lost to foreigners” and are often viewed as a consequence of the policy decision to liberalize trade in the first place.

Having said that, the challenge of adjusting to open trade is a serious issue that has not received the degree of attention it fully deserves. This may partly reflect the fact that the burden has been borne unequally and spread out over a long time period. It also may reflect the fact that the winners from trade have often tended to have a stronger voice than those who have been the losers.

Research has documented that the effects on individuals of job dislocation—including those resulting from trade—can be significant and long lasting. Older workers tend to suffer larger earnings losses, and may face larger transition costs. Displaced workers may not have the appropriate skills to find good jobs in other areas of the economy, including in growing export sectors. When the affected industry represents a large share of the local economy, the damage is often magnified. In this case, the burden is more widespread because wages across the community are likely to be hit as well. And, this doesn’t begin to capture the full human toll—including the impact on workers who have lost confidence in the future and the poorer health outcomes that occur because of increased stress. For too many individuals in the United States, for instance, the American dream has been put at risk, with parents increasingly pessimistic about whether their children will have the opportunity to do better than they did.

We should find better ways to help communities that are struggling because of the effects of free trade. In the United States, we have historically experienced a high degree of geographic labor mobility—much higher than in other advanced economies. The ability to move in search of better opportunities, when possible, has helped to mitigate some of the adverse effects of trade. But, mobility has declined in the United States in recent years, implying that the adjustment costs to trade may have increased.

Protectionism Is Not the Answer

Given these costs of global integration and more liberalized trade, what is the best path forward? Protectionism can have a siren-like appeal. Viewed narrowly, it may be potentially rewarding to particular segments of the economy in the short term. Viewed more broadly, it would almost certainly be destructive to the economy overall in the long term.

Countries need to compete better, not compete less. Trade barriers are a very expensive way to preserve jobs in less competitive or declining industries. They blunt opportunities in export industries and they reduce the affordability of goods and services to households. Indeed, such measures often backfire, resulting in harm to workers and diminished growth.

A better course is to learn from our experience. From a U.S. standpoint, we should work to reduce remaining foreign trade restrictions that impair our ability to capitalize on our comparative advantages. For example, market access restrictions can mean that certain U.S. industries cannot realize their full potential. Similarly, weaknesses in the protection of intellectual property rights limit the ability of U.S. producers to realize the full returns from their investments. This lowers profits and diminishes incentives to grow the business and employ more workers.

If we are going to enhance the benefits of free trade and better manage its costs, it is critical that we continue to strengthen the global rules-based system. On the positive side, I would point to the WTO’s recent Trade Facilitation Agreement, which addresses customs procedures and could reduce global trade costs by almost 15 percent. But, at a broader level, the momentum behind global trade reform has clearly waned in recent years. This has occurred notwithstanding the fact that there are substantial areas in need of further reform, such as agriculture, services and non-tariff barriers. That

momentum needs to be rekindled and reaffirmed. Although advanced economies historically have tended to lead the way, it is important that large emerging market countries now play a greater role. This is appropriate given their growing prominence in the global economy.

There are many approaches to dealing with the costs of globalization, but protectionism is a dead end. Trade restrictions address the symptoms and not the underlying problems, and they introduce other costs and distortions. While such measures might generate temporary boosts to growth from greater domestic production and consumption, these would likely be offset by a range of other costs. Over time, such measures would retard productivity growth and thereby shrink the economic pie. As an illustration, import substitution models that were pursued by many emerging market economies following the Second World War eventually led to lower long-

term growth outcomes. This was the experience in India, which helped trigger the reforms of the early 1990s.

In assessing the benefits and costs of trade, it is important to understand that a nation's trade balance reflects much more than its trade policy. Just as important are the country's saving and investment spending proclivities, which are affected by many factors, including tax and fiscal policies. For example, in the United States, we have a chronic trade deficit because domestic investment spending exceeds our domestic saving. Foreign capital inflows make up the gap. In this process, the foreign exchange value of the dollar plays an important equilibrating mechanism. If the domestic saving/investment imbalance is unchanged, then any reduction in the trade balance from higher trade barriers will be offset by lower exports. The domestic currency will appreciate to cause the trade deficit to widen to accommodate the desired capital inflows. Thus, trade restrictions affect the composition of trade but not the gap between exports and imports, which is determined by the difference between domestic savings and investment. At the end of the day, the protectionist country would produce more goods in sectors protected by higher trade barriers but also fewer goods for export.

The expectation that higher trade barriers would save jobs ignores these critical second-round effects.

Moreover, the story may not end there. What happens if another country that now faces higher trade barriers responds by raising its own barriers? That would push production even further out of high-value-added exports that are now deterred by the higher foreign trade barriers and into those exports that face lower trade barriers, or into the goods protected by the higher domestic trade barriers. Raising trade barriers would risk setting off a trade war, which could damage economic growth prospects around the world.

Measures that raise trade barriers typically would protect lower-wage, import-competing jobs, but would also weigh on the prospects for jobs in the more efficient export sector, which tend to be higher-paying. The outcome would be countries producing more where they have a competitive disadvantage, and less where they have a competitive advantage—the exact opposite of what we should be aiming for. For example, in the United States, one of our largest manufacturing exports is aerospace parts (which requires skilled labor) and one of our largest imports is apparel (which requires less skilled labor).

These second-round effects would also likely hurt productivity growth. Scarce resources would be used less efficiently and trade protection would likely lessen the level of competitive pressure that helps drive innovation. Moreover, lower productivity growth would likely lead to a slower improvement in a nation's living standards over time.

This negative consequence of higher trade barriers can be illustrated most starkly by the estimates of the costs per job saved through protectionist measures. Researchers that have studied this closely estimate that the costs per job saved from protectionist measures in the United States typically run into the hundreds of thousands of dollars per year. To illustrate, consider the case of import restrictions on Chinese tires. The cost of a job saved was estimated at \$900,000 per year while the measures were in place, or more than 20 times the average worker's compensation.⁵

5 Hufbauer and Lowry, "US Tire Tariffs: Saving Few Jobs at High Cost", Peterson Institute for International Economics, April 2012

Better Approaches to Deal With Globalization

Rather than protectionism, a better policy would be to help domestic workers and companies compete more effectively, rather than compete less. We need additional mechanisms that allow us to more fully capture the benefits from liberalized trade and to more proactively mitigate its costs. Ideally, policy should also better address job losses and income inequality from automation and other technological advances.

How we respond should depend on regional and industry circumstances. These include the nature of trade impacts, the skill sets and location of the workers that have been affected, and the amount of resources that can be mobilized to facilitate adjustment.

Increasing specialization brings real economic benefits, but can also leave workers more exposed to shifts in demand for their services, potentially on short notice. These issues are not going away, especially as emerging market economies take on a larger role in the global economy and automation continues apace. If we are to maintain a more open trade regime, globalization must be socially and politically sustainable. For that to be the case, we have to provide greater support to those who are hurt by trade.

Policies should include more assistance with job retraining, help with job search and mobility, and broader unemployment support. We need to do more research into what measures have been effective in economies around the world, and we should encourage greater experimentation with new approaches. Getting the balance right between providing assistance and making sure that individuals hurt by trade can get back on their feet and achieve their earning potential will be a challenge, and we need a better understanding of what actually works.

More generally, we need to do a better job positioning our workforce to cope with globalization and technological change. This will involve improvements across a range of areas, including not only education and training, but also the business regulatory environment and infrastructure investment that could support greater worker mobility. These measures would also promote higher productivity growth. While the scope and scale of issues differ substantially by country, many of these policy areas may also be relevant in India.

Lastly, there are various measures available in current trade agreements, such as antidumping measures and countervailing duties for dealing with “unfair” trade, as well as escape clauses that provide safeguards for industries that face a sudden surge of imports. Again, the challenge is to ensure that such measures are effective, that they help facilitate rather than retard adjustment, and that they are not abused so as to avoid foreign competition. But, both sanctions and temporary relief have been provided for in global trade rules. We should be willing to use them when their use would lead to more equitable outcomes and would help sustain political support for a more open trade regime.

Conclusion

Free trade is a concept that remains compelling but periodically will be tested by economic change. That is an inescapable fact of life and is a good thing because it requires the economics profession to articulate anew the value of a liberalized world trade regime. While the value from trade is very high, the associated adjustment costs can be significant and will require greater attention if globalization is to work for all of us.

Thank you for your time. I would be happy to take some questions.



AND THE BLAME GOES TO ... EU TAX INTERMEDIARIES

by **PIERGIORGIO VALENTE**

Chairman IAFEI International Tax Committee, July 10, 2017, Link Campus University, Rome, Italy

Introduction

In June 2017, the European Commission released the fiercely debated proposal for a directive to introduce mandatory disclosure rules in the area of taxation (Proposal) in the European Union (EU)¹.

The proposed legislation is highly relevant to EU tax professionals but also to enterprises with activities in the EU, implementing tax planning structures that could potentially be regarded aggressive. Specifically, such enterprises may under certain circumstances have own obligation to report information to national tax authorities. In any case, they must be aware that potential tax planning structures they might use shall become reportable and subject to automatic exchange of information among Member States², once the Directive is implemented.

Mandatory Disclosure Rules have been examined by the OECD in the framework of the Base Erosion and Profit Shifting (BEPS) Project³ and in particular in Action 12 (Disclosure of Aggressive Tax Planning). It was concluded that relevant legislation should be straightforward, precise as to identification of the structures triggering disclosure obligations, effective, flexible and limited by the principle of proportionality⁴.

1 European Commission, Proposal for A Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements, COM(2017)335 final, June 2017, available at: https://ec.europa.eu/taxation_customs/business/company-tax/transparency-intermediaries_en

2 The new rules are suggested to be inserted as amendment to the existing Directive regarding Administrative Cooperation (Council Directive 2011/16/EU - DAC). Thus the scope of the DAC shall be expanded.

3 According to the OECD BEPS “refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations.” Identifying appropriate actions to tackle BEPS at international level has been the mission of the inclusive framework, consisting of over 100 jurisdictions. Cf. OECD, About BEPS and the Inclusive Framework, available at: <http://www.oecd.org/tax/beps/beps-about.htm>

4 OECD, Mandatory Disclosure Rules, Action 12 – 2015 Final Report, 2015.

Legislative action to this effect at EU level was conceived to respond to Panama Papers leaks. Committed to eliminate such phenomena, the Commission listed one year ago (in July 2016), a number of measures to enhance tax transparency in the EU and improve the function of the Single Market⁵. Amongst others, anti-money laundering legislation, beneficial ownership, whistleblowers’ protection and increased oversight of tax advisors’ activities were brought forward. As a result, the rules examined herein are promoted as complementary to other legislative measures, already adopted or under consideration. The specific purpose assigned to these rules is twofold: (i) to ensure that Member States are promptly informed on aggressive tax planning schemes and can react effectively and (ii) to discourage tax professionals from involvement with arguable arrangements.

The essence of the new rules lies with the obligatory reporting to Member States’ tax authorities of cross-border arrangements involving at least one Member State before implementation, where possible, or following first taxpayer’s implementing actions⁶. The obligation is triggered where the arrangements have one or more of the features identified in the Proposal as hallmarks⁷. In particular, there are four categories of hallmarks:

- (i) generic,
- (ii) specific, linked to the so-called main benefits test,
- (iii) specific, related to cross-border transactions and
- (iv) specific related to automatic exchange of information in the EU.

5 European Commission, Fair Taxation: The Commission Sets Out Next Steps To Increase Tax Transparency and Tackle Tax Abuse, Press Release, July 2016.

6 The deadline for the fulfillment of the obligation depends on the reporting subject. In principle, tax intermediaries designing or implementing suspicious arrangements must report them within 5 days from their complete communication to the taxpayer. Nevertheless, taxpayers may proceed with reporting after the first implementing actions.

7 Cf. Annex to the Directive “Hallmarks”.

Arrangements with features of categories (i) and/or (ii) fall under the Proposal's scope provided that their principal foreseeable implication is tax-related (main benefits test). Category (iii) includes a set of identified strong indicators of tax avoidance and aggressive tax planning, e.g. arrangements involving entities without tax residence or exploiting mismatches of different national tax laws. Finally, category (iv) refers to features indicating intention to circumvent legislation on automatic exchange of information.

Primary reporting obligation is imposed on EU tax intermediaries⁸. Tax intermediaries are defined very broadly, apparently with a view to catching all professionals that might assist to the realization of the suspicious arrangements⁹. Hence any person (i) responsible towards a taxpayer for the "design, marketing, organization and/or management" of suspicious arrangements or (ii) materially assisting with the above activities may qualify as intermediary under the scope of the rules. It is clarified that where several persons are equally liable to reporting as intermediaries, the main obligation shall lie with the one(s) assigned with the arrangement's design and/or implementation.

However, there are cases of tax intermediaries that either fall outside the scope of the Proposal or can be exempted from the respective obligations. As said above, the new rules are limited to EU tax intermediaries. Consequently, persons that are not sufficiently connected with any EU Member State, under one of the four criteria provided in the Proposal, do not have reporting obligations. Furthermore, persons qualifying as intermediaries but enjoying legal professional privilege in their Member State have the right to waive the discussed obligations. Where no intermediary has reporting obligations, either for one of the above reasons or because the suspicious arrangement is designed and implemented without involvement of tax professionals, the reporting duty falls on the relevant taxpayer.

It is questionable whether the Proposal is fit for the purposes assigned thereto. The most alarming question arising upon its reading refers to the definition of "arrangement". Despite the fact that the Proposal's whole essence is the reporting of arrangements, no clear delimitation of the term is given. Similar question-marks emerge in relation to other core parts of the Propo-

sal. Indicatively, it is arguable when an arrangement is made available by the intermediary to the taxpayer for implementation, thus triggering reporting obligations. Similarly, clarifications are indispensable for the application of the main benefits test. From the above arises a clear and direct risk of tax uncertainty, with harmful implications for the function of the Single Market and its attractiveness to foreign investment. In addition, such measures could be held to undermine existing rules on tax professionals' conduct (e.g. professional codes of conduct) as well as their intrinsic professional ethos.

Another weak point of the Proposal relates to the extent compliance therewith may be enforced. Firstly, it is not clear how Member States (and the Commission) will verify fulfillment of disclosure obligations, especially to the extent they refer to arrangements not revealed otherwise (e.g. through Country-by-country reporting). Secondly, monitoring the success of the regime shall be especially challenging taking into account lack of data on arrangements not disclosed. Most importantly, taxpayers willing to take the risk linked with aggressive tax planning can always address to non-EU intermediaries, not covered by the regime. From this perspective, the regime could drive demand and offer of tax consulting services outside the EU without actually reducing aggressive tax planning in the Single Market.

Additionally, the Proposal risks to undermine the positive implications connected with and expected from cooperative compliance programmes, increasingly adopted around the EU. It has been repeatedly verified that cooperation between tax authorities and taxpayers can enhance significantly tax compliance in a globalizing tax arena¹⁰. Successful cooperation though pre-requires mutual transparency and trust as well as fair allocation of administrative and compliance burden between the parties. Nevertheless the measures envisaged in the Proposal introduce unbalanced new burdens for taxpayers and their advisers while building on generalizing assumptions as regards the latter.

Concluding, fairness in taxation is not only about fair distribution of tax burden but also – or more – about establishment of fair procedures and respect of taxpayers' rights. Uncertainty over tax obligations and unbalanced allocation of rights and responsibilities are not compatible with fair and effective tax systems. Despite its merits, we are not entirely convinced that the Proposal will be able to reach its said goals, at least at its current form. It might be more prudent to first evaluate the effects of legislation already adopted for the enhancement of transparency and then proceed therewith, if necessary.

⁸ The proposal explicitly limits the obligations to intermediaries incorporated / residents / registered / based in an EU Member State (art. 1 para. 1 point 21 of the Proposal).

⁹ According to Working Document accompanying the Proposal, the term is envisaged to include "consultants, lawyers, financial and investment advisers, accountants, financial institutions, insurance intermediaries, agents establishing companies or any other type of person involved in the design of structures potentially leading to tax avoidance". Cf. European Commission, Commission Staff Working Document Impact Assessment (SWD 2017(236)), June 2017.

¹⁰ OECD, Cooperative Compliance: A Framework, From Enhance Relationship to Cooperative Compliance, 2013.



Press, Journal Article

Payden & Rygel

POINT of VIEW

SUMMER 2017

Our Perspective on Issues Affecting Global Financial Markets

HOW WE LEARNED TO STOP WORRYING AND LOVE THE FED'S BIG BALANCE SHEET

The Fed's balance sheet unwind is all the rage in the media and the markets. Policymakers have committed to begin the process sometime later "this year." We expect a gradual unwind to begin by fall, but we aren't worried. Dire economic and market consequences from the Fed's balance sheet will prove more imagined than real. And the big balance sheet is here to stay along with a new role for the Fed in money markets.

Payden&Rygel

How We Learned to Stop Worrying and Love the Fed's Big Balance Sheet

One of the most discussed topics in 2017 has been the Federal Reserve's bloated balance sheet and the steps the Fed might take to reduce the bloat. Interest in the topic has reached a fevered pitch of late, with the number of media stories referencing the "Fed's balance sheet" spiking (see Figure 1).

The Fed itself has fanned the flames of market worries by suggesting that an unwind could begin soon and by publishing research to show that successive quantitative easing (QE) programs boosted equity prices by 11-15%, depressed longer-term interest rates by around 90 basis points (or 0.90%) and weakened the U.S. dollar versus its peers by up to 5%.

Given these alleged market impacts as the balance sheet grew, it is natural for investors to wonder whether the unwind will cause waves as the tide rolls out. Or, as one bond market observer remarked, "Who will buy all those bonds if the Fed isn't buying?"¹ We say, worry not. We think the Fed will seek to avoid a "Taper Tantrum 2.0" at all costs. Dire economic and market consequences from the Fed's balance sheet will be more imagined than real. And the big balance sheet is here to stay, as the Fed has discovered a new role for itself in the money markets.

THE BALANCE SHEET BASICS: THE GOOD OLD DAYS

Understanding a central bank's balance sheet requires a few basics. The primary purpose of the Fed's balance sheet—or that of any cen-

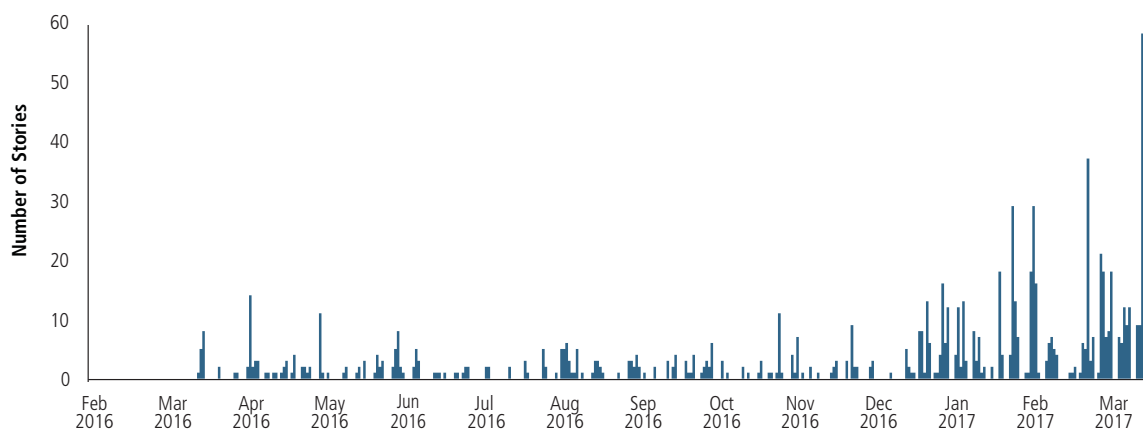
tral bank for that matter—is to back the nation's currency. To that end, the Fed holds assets to match its liabilities, which comprise the nation's money, in the form of bank reserves and physical currency.

«THE PRIMARY PURPOSE OF THE FED'S BALANCE SHEET—OR THAT OF ANY CENTRAL BANK FOR THAT MATTER—IS TO BACK THE NATION'S CURRENCY.»

Circa 2007 (before the balance sheet ballooned), most of the Fed's balance sheet consisted of Treasury bills on the asset side and currency on the liability side (see Figure 2 on page 2). In those days, as bank lending and deposit creation progressed, demand for currency and reserves increased. The balance sheet grew at roughly 5-7% per year for several decades, coincident with nominal spending growth (remember this, it will be important later).

Bank reserves were a tiny share of the Fed's liabilities. Then, as now, all depository institutions held bank reserves at the Fed, as prescribed by law, to meet minimum "reserve requirements." Think of bank reserves' function like an individual's checking account, save one detail: unlike a personal checking account, banks can temporarily skirt overdrafts.

fig. 1 MEDIA HOOPLA AROUND THE "FED'S BALANCE SHEET" TAKES OFF IN 2017



Source: Bloomberg

Payden&Rygel

Imagine the following situation: you overdraft your checking account and the bank calls asking for more funds (and charges you a hefty fee). Instead of running the overdraft, you call someone else who also banks at your bank and ask them to lend you money to cover your overdraft. If they agree, then the bank simply debits their account and credits your account. No more overdraft.

«BEFORE 2007, THIS “PHONE A FRIEND” MARKET WAS A SMALL, YET IMPORTANT MARKET. TOTAL RESERVE BALANCES AVERAGED JUST \$11 BILLION (MOSTLY TO MEET RESERVE REQUIREMENTS, NO EXCESS SAVINGS). EXCESS RESERVES, THOSE BALANCE HELD ABOVE AND BEYOND THE CALL OF REGULATIONS, AVERAGED JUST \$1.5 BILLION!»

The “phone a friend” equivalent in banking is an unsecured overnight market where banks borrow and loan reserves. The rate of interest banks charge each other is the famous “federal funds rate.” Before 2007, this “phone a friend” market was a small, yet important market. Total reserve balances averaged just \$11 billion (mostly to meet reserve requirements, no excess savings). Excess reserves, those bal-

ance held above and beyond the call of regulations, averaged just \$1.5 billion!² Since the market was so small, the Fed could manipulate the federal funds rate by either making reserves more scarce (for higher rates) or more plentiful (lower rates) relative to market demand.

POST-2008: MORE MONEY, MORE PROBLEMS

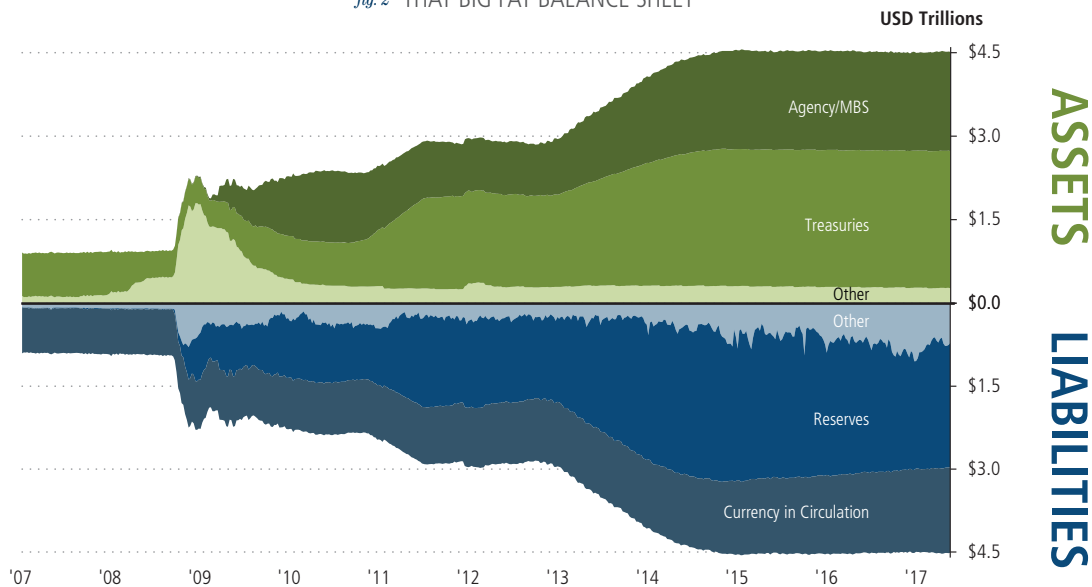
Under successive QE programs, the Fed increased the size of its balance sheet from \$800 billion to more than \$4.5 trillion (see again Figure 2). How did that happen? The Fed created \$2.6 trillion in new liabilities (reserves). Those reserves were exchanged with member banks for great quantities of Treasury notes, Treasury bonds and agency-backed MBS (the Fed’s assets).

As a result, today there is *anything* but a scarcity of reserves!

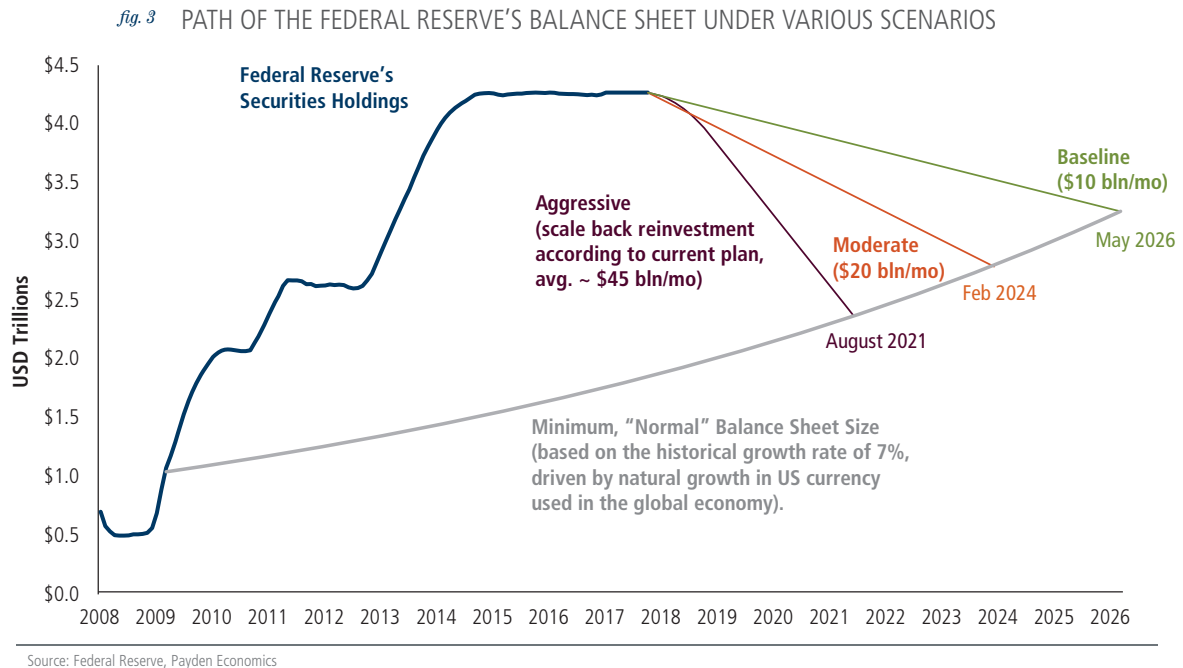
Of course, the surfeit of reserves created a new problem for the Fed: how to control the “phone a friend” interest rate when so many reserves were available. Why “phone a friend” when your account is flush with cash? Indeed, trading volumes are 75% lower in the “phone a friend” market than pre-crisis daily volumes.

At first the central bank settled on a solution: pay banks interest on excess reserves to, in the words of the New York Fed, “reduce the incentive for [banks] to lend at rates much below IOER (Interest on Excess Reserves) providing the Federal Reserve additional control” over the fed funds rate. If banks receive 100 basis points (the IOER for holding onto reserves), they will not likely lend them out to someone else for any less, thereby enforcing the federal funds rate.

fig. 2 THAT BIG FAT BALANCE SHEET



Source: Federal Reserve Board, WSJ
*Weekly End of Wednesday Levels



But reality upended the central bankers' best-laid plans. Officials learned that some participants in the "phone a friend" market could not legally earn the Fed's posted rate (we see you, Federal Home Loan Banks!). These participants in the market willingly lent out their excess balances for less than the posted rate. The Fed's first plan to manage front end interest rates failed.

«UNDER SUCCESSIVE QE PROGRAMS, THE FED INCREASED THE SIZE OF ITS BALANCE SHEET FROM \$800 BILLION TO MORE THAN \$4.5 TRILLION (SEE AGAIN FIGURE 2). HOW DID THAT HAPPEN? THE FED CREATED \$2.6 TRILLION IN NEW LIABILITIES (RESERVES).»

Necessity is, of course, the mother of invention. A team at the New York Federal Reserve Bank hatched a new plan to appeal to a wider array of money market participants. A new tool was born: the fixed-rate, full-allotment overnight reverse repurchase facility (ON RRP).³ Jargon-free, this new tool is just like having an overnight deposit account at the Fed for the non-bank institutions, with deposits backed

by collateral the Fed holds on its balance sheet (all the bonds acquired with QE!).

With these two new tools, the Fed has maintained an iron grip on overnight interest rates. Most important for investors, the use of the ON RRP means that for the first time in history, institutional investors (i.e., non-broker-dealers and non-banks, such as money funds) have direct access to deposits at the Fed—a bit like having a checking account at the Fed. Said differently, the Fed has its tentacles wrapped around money markets like never before.

MAKING BANK RESERVES SCARCE AGAIN!⁴

So the Fed's balance sheet is large. Yet policymakers seem intent on raising short-term interest rates. But, control of short-term rates depends, at least in part, on use of securities on the big balance sheet (the ON RRP).

Before we go too far, you might be thinking: "Well, if the Fed created all of these extra reserves to pay for the bond purchases under the various QE programs, *why not just sell the bonds?* By selling, reserve balances would also fall. Making reserves scarce would return the Fed to the comfortable confines of the pre-crisis mechanics in order to impact overnight interest rates by constraining or expanding the supply of reserves. End of story. Right?"

Not quite. While this is the first and simplest option, the Fed has a problem with selling the bonds before hiking interest rates to an

as-yet-unstated level. The uncertainty of selling all those bonds may spook the bond market. Consider that a few words from former Fed chairman Ben Bernanke spoken in spring of 2013 sparked a 150 basis point sell off in 10-year Treasuries (the so-called “Taper Tantrum”), which, in turn, spiked mortgage rates and sent home sales into a renewed slump.

The minutes of the March 2017 FOMC meeting show that the Fed prefers a “passive and predictable” roll-off of both Treasuries and MBS.⁵ We learned in June 2017 what this would mean. The unwind process will permit \$6 billion of Treasury securities and \$4 billion of agency debt and mortgage-backed securities (MBS) to roll off the Fed’s balance sheet each month. Note: the Fed will not be selling assets, only collecting the coupon, principal and maturity payments below the \$10 billion monthly “cap” and returning those proceeds to the U.S. Treasury—just like any normal bond investor might sweep maturities out of a portfolio to meet payroll obligations instead of selling a bond. If future economic conditions warrant shrinking the balance sheet further, every three months the initial caps will increase by \$6 billion (Treasuries) and \$4 billion (agency and MBS), up to a maximum of \$30 billion in Treasuries and \$20 billion in agency and MBS per month.

In the meantime, since the future is unknown, we’ve mapped out three scenarios for the balance sheet (see Figure 3 on page 3). Even in the “aggressive” scenario in which the Fed ceased all reinvestment of the proceeds of its bond portfolio today—and maintained that policy for four years—the balance sheet would still exceed \$2 trillion in 2021. Further, as mentioned above, the balance sheet would have grown

naturally without the crisis of 2008. A simple extrapolation at the historical rate of growth in demand for the nation’s currency of 7% puts a floor under the balance sheet over time (the gray line).

Given what we know now, our best guess is that by decade’s end the balance sheet will still be \$2-3 trillion. But the intersect between those two lines may end up being higher. In short, a big balance sheet in dollar terms is here to stay—we are not going back to \$800 billion.⁶

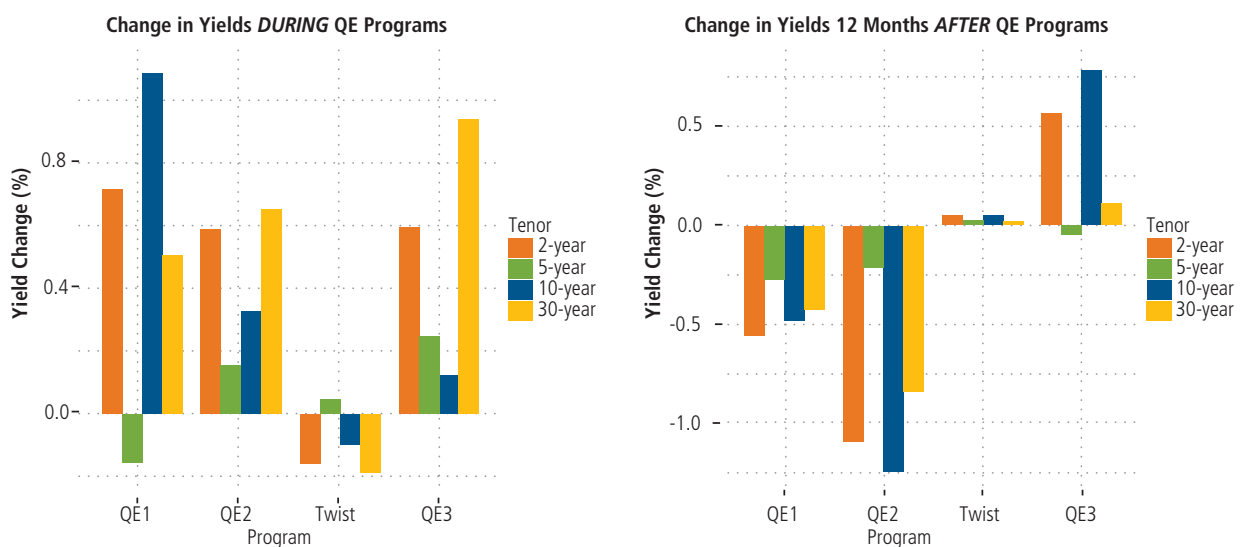
«THE LESSON: INVESTORS SHOULD INFER VERY LITTLE ABOUT THE DIRECTION OF LONGER-TERM RATES FROM CHANGES IN THE FED’S BALANCE SHEET.»

EMBRACE THE BIG BALANCE SHEET

Inquiring bond investor minds want to know: what does the unwind mean for interest rates? Telling the tale above is absolutely necessary for understanding what might happen next. We reach several conclusions, first concerning short-term rates and second longer-term rates.

The Fed’s control of short-term rates has been successful so far, and the Fed’s ability to control the federal funds rate and other short-term interest rates will remain the key tool of monetary policy. All else

fig. 4 WHAT DOES THE BALANCE SHEET MEAN FOR THE LONG-END OF THE YIELD CURVE? IT IS HARD TO SAY.



Source: Federal Reserve, Payden Economics

equal, the faster the pace of balance sheet run-off, the slower the pace of rate hikes, and vice versa.

In the words of Janet Yellen from a January speech, “The downward pressure on longer-term interest rates that the Fed’s asset holdings exert is expected to diminish over time—a development that amounts to a ‘passive’ removal of monetary policy accommodation. Other things being equal, this factor argues for a more gradual approach to raising short-term rates.” Hiking rates quickly while the balance sheet shrinks rapidly amounts to too much monetary policy tightening for the Fed’s tastes.

At the longer end of the yield curve, the “conventional wisdom” seems to be that “when the Fed stops buying, interest rates rise” because “who will step in when the Fed steps away?” As we are fond of pointing out, the conventional wisdom is often wrong. We looked at four historical examples of when the Fed ceased or curtailed purchases, and in three out of four instances interest rates rose when the Fed was buying. Further, of the four 12-month periods after buying ceased or was curtailed, two periods saw interest rates fall (see Figure 4 on page 4). The lesson: investors should infer very little about the direction of longer-term rates from changes in the Fed’s balance sheet.

HERE’S SOMETHING TO THINK ABOUT

Yes, the Fed’s balance sheet is bloated. But, no, you shouldn’t worry—at least not about the concerns voiced most often (higher rates). Policymakers aim to reduce the balance sheet gradually over time. While most investors focus on the asset side shrinking, we see minimal impact to financial markets.

The real story to watch will be the evolving relationship of the Fed to money markets. As a result of its big balance sheet, the Fed, for the first time in its 100-year history, now engages with non-bank, non-primary dealer participants in the money markets, redefining the Fed’s relationship with financial markets. Rather than going through a dealer, money market funds (among others) can directly transact with the Fed. By lending out securities, the Fed will be able to influence the bond market more directly. What central banker wouldn’t love more of this power? To continue this relationship, however, the Fed must maintain a bigger balance sheet. While there are many unknowns, including who will helm the Fed if Janet Yellen departs at the end of her term in January 2018, we suspect central bankers will learn to embrace the bigger balance sheet.

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6. Inquiring minds may wonder whether the balance sheet will shrink as a share of GDP, not merely in terms of absolute value. On this basis the balance sheet will indeed move back toward a more “normal” level over time as the economy grows.

JOINING THE PARTY OR JUMPING THE GUN? MAJOR CENTRAL BANKS POLICY RATE TARGETS

Chart of the Week, For the Week Ending July 14, 2017 by **Payden & Rygel**, Investment Management, Los Angeles, USA, July 14, 2017.

CHART OF THE WEEK

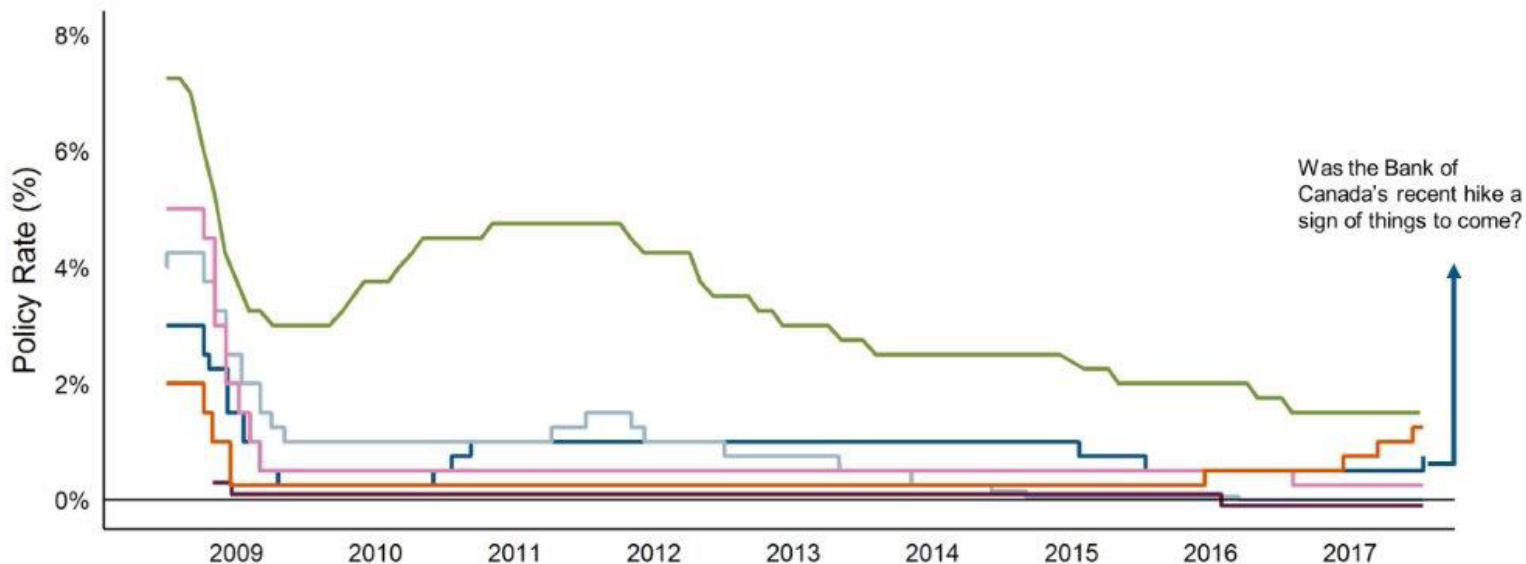
Payden & Rygel
Investment Management

Joining the Party or Jumping the Gun?

Major Central Bank Policy Rate Targets

For The Week Ending 07/14/17

Australia Canada Euro Area Japan United Kingdom United States



Sources: Royal Bank of Australia, Bank of Canada, European Central Bank, Bank of Japan, Bank of England, Federal Reserve

This week, the Bank of Canada raised its overnight rate target for the first time since 2010. The Canadian central bank followed in the American central bank's recent footsteps, choosing to look through low inflation readings (core CPI is up only 0.90% year-over-year as of June in Canada). The Bank of Canada said, "Canada's economy has been robust" and cited the fact that "a significant amount of slack has been absorbed" as a reason to raise the monetary policy target rate. The Canadian situation looks similar to that of the US: above-trend economic growth and evaporating "slack" means central bankers expect inflation to edge higher. Some bond traders think both banks are jumping the gun. Time will tell.

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