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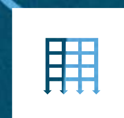

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EDITOR'S LETTER

Dear GTNews subscriber,
A very warm welcome to the relaunch edition of Global Treasury Briefing - our first for nearly a year.
Over the past 12 months the business world has certainly not stood still and GTNews has itself undergone significant change. As regular readers will know, after eight years during which our parent was the Association for Financial Professionals (AFP) in the US the website re-launched under its new owner, Contentive Media, last September. Having relocated briefly to the AFP's offices outside Washington DC, we're also once again based in London and at the centre of the world's most dynamic financial centre.
The changes also provided us with the opportunity to review GTB's content and remit. The magazine initially served as a shop window for GTNews, republishing the best recent articles and blogs from the website. Latterly, we added some original commentary to complement these items. We've decided to go further in this direction and develop GTB as a stand-alone publication with its own identity and original content, which we believe will firmly establish the title as a unique thought leadership resource.
You'll see the change reflected in the following pages. Our cover story. 'Treasury at a time of uncertainty' offers an in-depth analysis of four issues that treasury departments must assess in 2016: the European business environment ahead of the UK's June 23 referendum on its EU membership; the outcome of the US presidential elections and the prospect of greater protectionism; continuing currency volatility; and the prevailing environment of low, even negative, interest rates.
We're also pleased to offer a regulatory focus on the Solvency II regime, a report on the potential of Africa's dynamic emerging economies and two contrasting interviews- one with Microsoft's George Zinn, the other with Marianna Polykrati of Athens-based food group Chipita who describes how it has survived testing economic times in Greece.
We hope that you'll enjoy the new-look GTB and welcome your comments on how the magazine can continue to best serve your needs. Our next issue will be published in early September.

Best wishes,

Graham Buck
GTNews editor

AFRICA HAS PROVED A CONTINENT OF CONTRADICTIONS OVER THE PAST FEW YEARS. CORPORATIONS AND COMMENTATORS ALIKE HAVE BEEN ALERT TO THE CONTINENT'S POTENTIAL, AND A GROWING RANGE OF INDUSTRY SECTORS HAVE INVESTED.

BY NICK DIAMOND

HEADING FOR A BRIGHTER AFRICAN HORIZON

More recently, the impact of 'global' headwinds, which can have a far greater impact on emerging economies than developed countries, appear to have blown the great African ship off course. It is not lost on voyage, however, but it is undoubtedly following a new route. The question for corporations doing business in Africa is how they should adjust their expectations, and how they can steer a new course given the obstacles along the way.

A CHINA CRISIS IN AFRICA

The fall in oil and other commodity prices continues to have an enormous impact on commodity-producing African economies, with far-reaching implications across society - not least due to the resulting drop in government income and greater difficulty in servicing their debt. This is exacerbated by the cooling of foreign fervour for investment in Africa, notably from China.

When Chinese Premier Li Keqiang visited Africa in 2014, he indicated that China expected to invest US$100bn in Africa by 2020, and for the value of trade to reach US$400bn. Within a year later, Chinese investment had fallen by 84%. Furthermore, while Chinese imports overall reduced by 13% between October 2014 and October 2015, the value of imports from Africa fell by 32% according to Thomson Reuters Datastream.

Certain countries are particularly affected, with Angola, South Africa, Republic of Congo, Equatorial Guinea and Zambia accounting for more than 70% of all African exports to China. Meanwhile, Chinese imports to Africa are rising, creating a serious trade imbalance.

TAKING THE LONG TERM VIEW

Despite the impact of the commodity crisis, and Africa being buffeted more strongly by global headwinds than other regions, all the factors that were attractive to investors in the first place either still exist, or will do so again.

Consequently, treasurers and finance managers operating in, or with responsibility for Africa are not coming to their banks to help them execute an exit strategy. Instead, they are revising short- to medium-term growth forecasts, and seeking help from their banks to overcome short term challenges, and position their businesses for the future. As a result, banks such as Standard Chartered with a long-term, proven commitment to African markets are in greater demand than ever before to provide advice and support.

A FOREIGN CURRENCY DROUGHT

A major obstacle in commodity-exporting markets is the lack of foreign currency liquidity; probably the single biggest challenge with which corporations are faced. With most commodities transactions denominated and settled in US dollars (USD), the fall in prices has led to a foreign currency drought, so customers are having to work with their banking partners to find that liquidity where they can, or paying in local currency as a last resort.

This results in 'trapped' cash as companies build up local currency balances that cannot easily be repatriated or exchanged, with associated tax and risk implications. Treasury's view on liquidity and currency management can play an increasingly important factor in the sales organisations' strategy to invest in countries; particularly if the resulting proceeds effectively have no value to the business.

DIVERSITY AND COMPLIANCE

While foreign currency liquidity constraints affect commodity-producing countries in particular, the diversity of regulations across Africa affects every organisation. Despite harmonisation initiatives such as the West African Economic Monetary Community (WAEMC) and Central African Economic Monetary Community (CAEMC) treasurers need to consider the specific regulatory and tax issues, financial infrastructure and government strategies in each country - such as Nigeria Vision 2020 and Ethiopia 2030 - and plan their liquidity and risk strategies accordingly.

This task is complicated further by the need for governments and central banks in oil-dependent countries such as Nigeria to protect liquidity and improve market and investor confidence to respond to evolving market and economic conditions, which often takes the form of regulatory change. It is very difficult for treasurers operating in multiple markets within Africa to keep up with the pace of change and understand the potential compliance implications. As a result, they rely on their core banking partners to be their 'eyes and ears' on the ground. By engaging proactively with governments and policy makers, their banks are able to alert clients to changes promptly, and advise on the implications.

EVOLVING BANK STRATEGIES

The collapse in oil prices and the resulting liquidity constraints, economic instability and regulatory shifts have inevitably affected market confidence. In these circumstances, organisations tend to turn to their trusted, typically international, banking partners. The difficulty, however, is that just as corporations and investors have had to review their Africa strategy, so too have international banks. As recent reports have evidenced, some banks have been obliged to exit the region, which has further fuelled a lack of confidence. Treasurers have therefore sought reassurance from their banks about their long-term commitment to the region.

Even so, although treasurers would typically prefer to work with a small number of international banks, local banks play an important role in Africa and are often essential partners for treasury. As a result, treasurers often need to maintain a larger number of bank relationships than in other regions. In this situation, it can be difficult to maintain operational efficiency and consistent processes, as well as managing counterparty risk and

liquidity effectively.

Concerns over fragmentation and loss of control is driving significant interest in electronic banking solutions, and multi-banking solutions such as SWIFT, in order to achieve better visibility and control over financial and information flows. Furthermore, Standard Chartered supports a growing number of clients, particularly amongst non-government organisations (NGOs), in implementing cross-border cash pooling, such as in WAEMC and CAEMC, which can be instrumental in supporting liquidity and risk objectives.

BANKING THE ECOSYSTEM

It is not only counterparty risk which is causing concern amongst treasurers, but also supply chain risk. Although larger, foreign multinationals are in a better position to access cost-effective financing than smaller companies, they recognise that they can leverage their credit quality to provide their supplier with cost-effective access to financing, and therefore increase the resilience of their supply chain.

Standard Chartered has a crucial role to play in achieving this. As a multi-tier bank, it supports small businesses through to large multinationals in each market in which it operates. Therefore, treasurers recognise that the bank's value extends not only to providing payments, collections and trade finance solutions to them, but also that it provides these services to their clients and suppliers. As a result, there is increasing demand for supply chain finance and other supply chain tools to strengthen the bonds in a company's supply chain, secure vital suppliers and reduce supply chain costs by lowering financing expenses.

A GLOBAL LEADER IN DIGITAL FINANCE

While liquidity and supply chain solutions play a vital role in helping companies to overcome the current period of uncertainty, Africa is also leading the way in the use of digital solutions to increase financial inclusion, and enable more efficient and secure ways of doing business. No other region has proved as adept at leapfrogging legacy financial and trading models and technology, benefitting businesses and consumers alike. Through its digital Africa strategy, which comprises 20 markets, Standard Chartered works with a range of partners, such as telecom providers, to realise the potential of mobile wallets and other digital solutions.

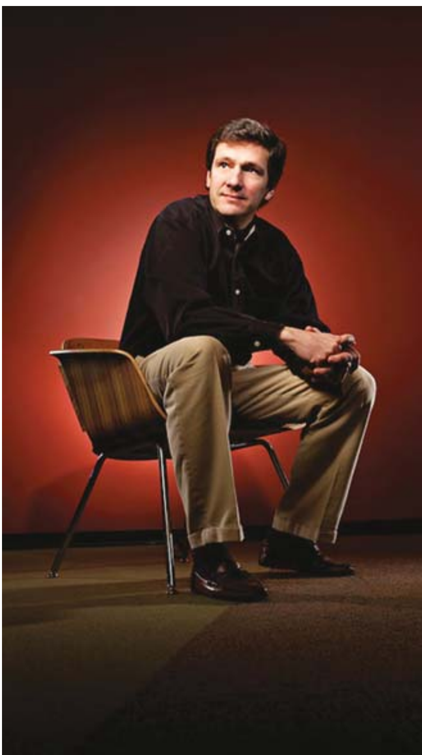
While Africa has been impacted more significantly by the fall in commodity prices and slowdown in China than any other continent, its growth potential remains as compelling as ever. Companies have revised their short - and medium - term growth forecasts, but they remain committed to both contributing and benefitting from the opportunities that will re-emerge. Standard Chartered is central to many of these companies' strategy, based on the depth of its local and cross-border solutions, market and regulatory expertise and investment in innovation. Most significantly of all, it has a long-standing, proven commitment to fuelling development and growth in Africa, and for those clients who operate there.

Nick Diamond is head of global corporates, transaction banking Europe, for Standard Chartered Bank

MICROSOFT: HARNESSING INNOVATION IN TREASURY

BY REBECCA BRACE

GEORGE ZINN, CORPORATE VICE PRESIDENT AND TREASURER OF MICROSOFT, IS RESPONSIBLE FOR INVESTING AND MANAGING ITS CORPORATE ASSETS. HE LEADS A TEAM WHICH MANAGES THE GROUP'S WORLDWIDE FINANCIAL AND CORPORATE RISK, INVESTMENT PORTFOLIO, STRATEGIC PORTFOLIO, FOREIGN EXCHANGE, CORPORATE AND STRUCTURED PROJECT FINANCE, DILUTION MANAGEMENT, CASH AND LIQUIDITY, CUSTOMER FINANCING AND COLLECTION ACTIVITIES



How have you leveraged technology over the past few years?

The treasury team at Microsoft has always been highly focused on leveraging technology. Even over the past decade, the business has grown tremendously - our revenue has more than doubled from approximately US$40bn in 2005 to over $90bn in 2015. Meanwhile, the size of the treasury team has not changed much. So how do we get everything done? The answer is by leveraging technology.

This has played out in different ways over the last decade. Where cash management is concerned, our goal was to be bank agnostic: to connect with our banks via SWIFT rather than bank specific virtual private networks (VPNs) and to have a standard messaging format. We started with MT messages and at this point we are on SWIFT ISO 20022 XML for both bank reporting and payments. We have standardised to XML across treasury and accounts payable teams and this has been very helpful in managing data flow and partnerships with our banks.

Once we had electronic visibility for our cash around the globe, and understood what the counterparty exposures were, we really wanted to be able to drive real time business intelligence based on this data - particularly following the 2008 crisis and other geopolitical events in different countries. We focused on creating actionable, visual business intelligence and have leveraged several technologies such as Microsoft SQL 2014 and SharePoint where we can house all of this information. We've leveraged Office 365 and Power BI capabilities, available both in Excel and in structured query language (SQL) environment, so that the treasurer, chief financial officer and chief executive can get business intelligence (BI) at the click of a button.

We can now see our global cash positions by country, by currency, by Microsoft entity and by bank in real time. This level of BI is useful for technology companies in the US, where a lot of our cash tends to be offshore, creating geopolitical exposures. The drill down functionality

also helps our business executives with key strategic decisions like share buybacks or acquisitions.

The next phase we embarked on was about mobility: putting our data in the Cloud so it can be accessed anywhere, on any device (handheld or desktop) in a secure and reliable manner. For example, we are now able to process wire payments - including large dividend payments and bond interest payments - through our Windows 10 phones, with the relevant approval process and user authentication happening in a very secure manner over the phone.

Where do you plan to take it next?

Mobility enabled by Microsoft Cloud is where we are spending a lot of current efforts. Moving our data and applications to Microsoft Azure coupled with our Active Directory authentications allows us to access and process our data anytime and anywhere in a highly secure manner. We're also working on analytical modelling. We are using machine learning algorithms to forecast non- US dollar (USD) account receivable data and hedge our foreign exchange exposures more effectively.

The other area we are looking at is blockchain - particularly the scenarios where blockchain could be really helpful to corporations. Microsoft provides the technology via Azure Blockchain as a Service (BaaS), and we're working with strategic banking partners to explore use case scenarios for corporate treasury teams. As with most new technology, it may take several years for this to come to fruition.

What are the most interesting use cases that could emerge for blockchain?

There are several possibilities. For one thing, all corporate treasury teams manage investment portfolios - some more complex than others. From the moment the trade is initiated, the trade confirmation and eventual movement of cash and underlying security can take three days. For a cross-border trade, this can be even longer.

A lot of authentication, trade confirmation and legal documentation leads to delays in settlement. The question is how we can speed up these processes to achieve same day settlement. To me that is a very realistic use case scenario for blockchain. For corporates, this would mean lower counterparty risk because the trade is settling the same day. There would also be a much lower regulatory capital requirement, reducing the cost of operations for the banks and therefore for their clients.

What are the possible obstacles?

This technology is still in a nascent state. It is important to consider who is going to be authenticating the identity of the bank and the corporate. Once blockchain is used to transact real currencies rather than crypto currencies, we will also need to have legal contracts in place to say that what's being represented in the blockchain is a real currency - also known as the tokenisation of real assets.

The other consideration is that if every bank comes up with its own way of doing blockchain messages, it's going to be chaos. We need to have a standards body to drive messaging formats and define how many characters are needed and what kind of information should be included and so on.

Are you keeping an eye on any other areas of innovation?

Yes. Moving to the cloud, Microsoft Azure for us, is very important to us. In addition, since the majority of our work in treasury involves banks and other financial counterparties, we want to ensure that they are also moving their data and applications to the cloud. For example, it is important for us to be able to access trade data and BI dashboards from these financial counterparties anytime, anywhere and on any device in a highly secure manner.

Related to this mobility theme is the area of business intelligence in the Cloud. We have a lot of systems that serve us well in managing currency risk, cash management and custody - but data on counterparty exposures, and on where cash is located, is distributed in different databases. If all your information is in the Cloud, you can manage your information in elastic big data

MOVING OUR DATA AND APPLICATIONS TO MICROSOFT AZURE COUPLED WITH OUR ACTIVE DIRECTORY AUTHENTICATIONS ALLOWS US TO ACCESS AND PROCESS OUR DATA ANYTIME AND ANYWHERE IN A HIGHLY SECURE MANNER.

stores called a Data Lake. If those databases are all connected within a single Data Lake, machine learning, analytics, dashboards and visualisations become seamless, agile and simple.

The move from data to decisions to action become easier. We essentially build mapping across these databases so that we can get an inter-connected and comprehensive view of our cash positions, financial exposures and counterparty risks. Microsoft's Power BI, Cortana Analytics Suite in Azure, is the tool we are leveraging for powerful visuals and dynamic drill down capability.

For example, if you are a sales executive and your team tells you that total sales in Europe grew 25% year-over-year, you could click on total sales and see the breakdown by country - let's say the UK. You could then click on the UK number and see who the end customers are and what type of products they are buying.

With such dynamic drill down capability, the executive can see if the overall growth is masking a negative trend in a specific country, or for a specific product, and take action. Strategic business decisions can be made in the moment, which is not possible when you have static information. We have implemented this in some areas and are looking to leverage the cloud for broader deployment.

How do you evaluate different developments to find out what's relevant?

In the past we did this very organically, with different teams tracking what was happening in their particular space. More recently we've created a new role reporting to me. This individual will help us think about what treasury will look like in five years - or longer - and how we can leverage technology to migrate from our current processes to our vision. He or she will help us coordinate with internal Microsoft technology teams, our banking partners and the industry to track and influence trends affecting treasury.

Do many of these innovations turn out to be red herrings?

Obviously not every trend develops into something that adds value - but there are several that do. For example, SWIFT took about six years to move from direct bank VPN to SWIFT ISO 20022 XML messages. Then, all of a sudden, there was a huge benefit to having standardised messages.

On the other hand, electronic bank account management, eBAM, is a great example of a trend that we tracked and worked on for so long, but that was not ultimately realised by us or by any other corporates in the way we all wanted. So not every trend pans out - but I think it's important to be aware of them and to assess how much time you invest in pursuing them.

TREASURY AT A TIME OF UNCERTAINTY

The flavour of 2016 was provided at the very beginning of the year, when China's stocks and currency slumped alarmingly and set alarm bells ringing across markets around the globe. At the end of last year, the outlook was for steady recovery in the US allowing the Federal Reserve to slowly and steadily raise interest rates - a process begun in December with the first hike since before the 2008 crisis. In Europe, it was hoped that the benefits of quantitative easing would fan the first stirrings of economic revival into life.

Instead, renewed jitters over the direction of the world's second-largest economy appears to have replaced this scenario with one that's less benign. The Fed has been signalling that further rate rises are not a priority. Zero to negative interest rates appear to no longer be a temporary phenomenon but one that is spreading to other central banks, such as Japan's. A stronger US dollar is creating the biggest dent in corporate earnings since those experienced in the depths of the euro crisis in mid-2012.

The last thing that this fragile environment needs is further uncertainty. Yet in Europe, attention is focused on the UK referendum of June 23 and the possibility of a 'Brexit', while in the US the unexpected success of Donald Trump in the presidential campaign threatens to usher in an era of damaging protectionism.

In the following pages, our writers offer an in-depth analysis of currency volatility; zero-to-negative interest rates; the consequences of Brexit and the post-Obama economic outlook in North America. All of which are giving treasury departments on both sides of the Atlantic reason to hone their risk management skills.

HAVING SURMOUNTED THE THREAT OF BREAK-UP FOUR YEARS AGO, THE FUTURE OF THE EUROPEAN UNION IS AGAIN UNCERTAIN AS A REFERENDUM ON JUNE 23 RAISES THE SPECTRE OF THE UK EXITING, REPORTS **PETER WILLIAMS**

COUNTING THE COST OF BREXIT

A credit crunch and a sterling crisis could be key costs associated with the UK referendum on the county's continuing European Union (EU) membership, which will be decided on June 23. The warning comes not from a politician in the 'Remain' camp but from the Bank of England at the end of March. Indeed, the risks outlined by the UK central bank echo many of the concerns that corporate treasurers are expressing - and not only those in the UK.

Treasurers' concerns over a possible 'Brexit' are Europe-wide. One treasurer that GTB spoke to said that his company - a Swiss-based multinational - had been following progress of the UK referendum closely. On February 21 Boris Johnson - Mayor of London and an MP in the British Parliament – confirmed after weeks of speculation that he would campaign for Brexit. "At that point I organised a meeting to discuss the potential risk for our UK business," says Pascal Y. Frey, head of group treasury at Swiss multinational Landis+Gyr AG, the smart meter and smart grid specialist.

The Bank of England has contributed clearly to the discussion of risk. Its financial policy committee (FPC) said that financial stability in the UK had deteriorated since November 2015 when it last met, adding: "Domestic risks have been supplemented around the EU referendum…any period of extended uncertainty following the vote, could increase risks to financial stability."

The Committee noted that the effect of uncertainty has been most marked in sterling spot and options markets. Back in February the pound had dipped below $1.40 for the first time since February 2009, when the global financial crisis was at its height. However, the FPC reckons worse could happen. It commented: "Looking ahead, heightened and prolonged uncertainty has the potential to increase the risk premia investors require on a wider range of UK assets, which could lead to a further depreciation of sterling and affect the cost and availability of financing for a broad range of UK borrowers." Ratings agency Standards & Poor's, which is the only one to maintain a top credit rating of AAA for the UK, suggested in February that a downgrade would follow a pro-Brexit vote.

With no hint of irony, the BoE also issued a warning to the EU saying: "The impact of a decision of the UK to withdraw from the European Union could spill over

to the euro area, driving up risk premia and further diminishing the prospects for growth there." One treasurer told GTB that as FX volatility - and indeed interest rate risk - will already be covered by corporates' treasury policies, unless something fundamental changes treasurers should expect both the treasury policy and the overall business strategy to continue unchanged in the short term. So, for example, a policy of FX hedging should continue as usual. The Bank's warning was echoed by the International Monetary Fund (IMF) on April 12, which warned that British exit from EU would inflict "severe regional and global damage"

While pro-Brexit campaigners have criticised the BoE for interfering in politics, and suggest there are other, greater risks, it could be argued that the FPC's conclusion had already been reached by treasurers. A reoccurring, dominant issue is the sheer uncertainty. According to Frey: "No one really knows for sure what will happen if the UK decides to leave the EU. I don't expect a disruption of business and trade but rather a drastic increase in foreign exchange rate volatility as well as changes to credit risk profiles that may lead to higher borrowing costs.

"In fact, there are as many arguments for a lower as for a higher sterling [GBP] value if the Brexit scenario does occur. In the short-term however, it's more the uncertainty that will lead to increased volatility. Treasurers don't like high volatility - nor does any non-financial corporation. As part of our function, corporate treasurers have responsibility for informing senior executives and defining strategies to mitigate treasury related risks - resulting from a geo-political event like the Brexit for example."

Business now has only a little time left before the UK votes on June 23. One treasurer told GTB that corporate contingency planning should see treasurers working alongside business strategy, tax and financial planning and analysis. Others that we spoke to suggested a different planning team, with key personnel including the head of supply chain, head of corporate treasury, head of insurance, head of procurement, chief operating officer and chief financial officer. In addition, for companies based outside the UK ideally the local UK subsidiary's finance director should be included and even assume the leader function.

Banks, insurance companies and fund managers are the sectors which should be most advanced in their contingency planning. Those sectors are most exposed to the key risks of any squeeze in liquidity and sterling sell-off in the event of a vote to leave the EU.

However, all sectors should be planning, according to Lee Taylor, head of business development in Continental Europe for global transaction banking software group iGTB. "Regardless of your stance on a Brexit, it is a great opportunity for corporations to pause and reassess," she says.

"Many companies missed a huge opportunity with the single euro payments area (SEPA) - mistakenly perceiving it to be something that affected banks only, and thereby missing a valuable chance to take stock of their operational structure and - in particular - revise and improve their liquidity management set-up. The potential for a Brexit, whether or not it actually materialises, is a similar market moment."

That planning, suggests another treasurer, should be co-ordinated through a task force that meets frequently, and topics that it covers should include general news development (updates on the referendum, polls, interviews, newspapers) to financials (situation of current bank relationship and accounts, credit rating changes, evaluation of capital control risk, credit default swaps and other company specific metrics) but also extend to suppliers (local or international suppliers, updates on how they are impacted or may be impacted, transport, logistics) and customer and supply chain (identify second supply chain opportunities, inform and reassure customers, logistics). From this, if time allows, a contingency report can be developed, which should be agreed by the board and can then be shared with key shareholders, which could include the supply chain.

As well as planning, it appears that action by some treasurers has already taken place. For instance, Mike Richards, head of treasury recruiter MR Recruitment, reports that one treasurer contact who he had placed into a money broking business reported 'insanely busy' dealing recently with levels of business not seen for years as corporates do all they could to protect themselves from foreign exchange (FX) risks as laid out in those treasury policies.

In the event of a vote to leave, treasurers see that longer term one significant risk for the UK is the decision of multinationals choosing to relocate head office functions - including treasury - or even whole businesses away from the UK. For instance, Jamie Dimon, chairman and chief executive of JP Morgan, hinted back in January the bank might leave the UK if Brexit became a reality. That hint feeds into fears over the impact on investment and planning for business during a period of uncertainty that would follow a leave vote.

By the end of June, we will know. However in the meantime the debate is bound to become louder and more heated. The government has already provoked fury from Brexiters by delivering a leaflet to every household - at a cost of £10m (US$14m) – that argues the case for the UK to remain in the EU. Unlike much of the media and many politicians, treasurers are noted for their calm: after all their core trade is dealing with substantial risks on a daily basis. As the polls suggest it is too close to call, corporates need treasurers to continue to think clearly under mounting pressure certainly up to June 23rd…and maybe beyond

INTERNATIONAL OUTLOOK: DISRUPTION AHEAD

FOR COMPANIES OPERATING IN THE EUROPEAN UNION – IN PARTICULAR THE UK – IT'S DIFFICULT TO THINK BEYOND THE EU REFERENDUM AT PRESENT, WHEN IT COMES TO MAKING RISK MITIGATION DECISIONS, SAYS **PHILIPPE GELIS**, BUT WHEN RUNNING A GLOBAL COMPANY IT IS IMPORTANT TO MAINTAIN A HOLISTIC VIEW OF ECONOMIC STABILITY AND CURRENCY VOLATILITY AT ALL TIMES, TO AVOID NASTY SURPRISES

Here are four things that companies operating internationally need to bear in mind to mitigate risk in the current economic market:

1) THE RISK OF A BREXIT

Let's address the beast first. It's certainly not the only issue affecting international - or even European - operations at present, but there's no doubt it's a big one. Uncertainty about the result of the referendum is attracting speculators to bet against the pound, which triggered a sharp sterling plunge in Q1 (16% against euro (EUR); 10% against US dollar (USD)).

It is likely that the pound will remain weak ahead of the Referendum on June 23rd. If the vote swings towards leave, the impact will be bigger still. Negotiations and decisions on how to drive forward an independent UK will not happen overnight; meaning this period of uncertainty would be prolonged even further. Uncertainty is the number one cause of market volatility and as such, a Brexit would likely trigger a sharp decline on the pound.

That is not to say that we'll experience an immediate return to stability in the event of an 'In' vote. The pound could appreciate quickly – as speculators close their short pound positions and the sterling could experience a 6% to 10% rise as result. Many UK companies that export overseas could be hit by losses from the negative impact on foreign exchange rates as they convert money from international customers and subsidiaries to pound sterling. These enterprises would be wise to hedge at the current pound value, to avoid a quick pound recovery from hurting their margins.

2) DOLLAR VOLATILITY

European uncertainty has also had an impact further afield. The US Federal Reserve stalled plans to approve four interest rate hikes this year, showing cautiousness in light of global economic uncertainty - the market has since priced in two. The result has been a weakened US dollar in Q1.

There is hope that an improvement in China's economic situation and a recovery in energy prices might spur the Fed to resume its monetary policy, ultimately pushing the dollar higher. However, April's Federal Open Market Committee (FOMC) meeting showed no change from their position in March. The meeting saw a 9-1 vote for maintaining rates at 0.25 to 0.50%.

3) CONTINUED EURO TROUBLE

In the great circle of economic turmoil, the Fed's step change in monetary policy has in turn impacted the euro, with the latter gaining roughly 5% against the dollar in April. However, this period of euro strength may be short lived, as fears around the future of Greece's economic future once again rear their ugly head. Donald Tusk, the president of the European Council, has called for an emergency meeting of eurozone finance ministers. Once again the situation looks rocky for Greece and all eyes will be on the country on July 20th – the deadline given to repay €2.3 billion to the European Central Bank.

4) COMMODITY DISRUPTION

From Norway to Australia, commodity currencies have been suffering lately due to the sharp decline of commodity prices; namely oil. The leading global producers of oil met in Qatar, Doha in April, to confirm a deal to freeze output and stem prices. However, the much anticipated deal fell apart when Saudi Arabia demanded Iran join the plan, despite Tehran's earlier confirmation that it would do no such thing. The immediate result was a sharp drop in the Russian rouble, the Canadian and Australian dollar currencies, and the Norwegian krone, as Brent dropped a further 7% to $41.

CREATING A RISK MAP

The global currency market is volatile in its nature, and even the slightest sign of economic trouble or geopolitical upheaval can have an impact on FX movements on a global scale - which is what we're experiencing at present on all fronts. As such, it's crucial that enterprises that operate internationally create a risk map to ensure they have systems and strategies in place to deal with inevitable market movements in the best way possible. This should include a detailed analysis of the markets and currencies on which the company depends, before making plans to either hedge or sell depending on the current state of the market.

Creating a risk map should be a job for the full management team – along with a dedicated internal or external FX expert. Political upheaval in a far flung country may seem of no significance to some enterprises, but the reality is that a sharp currency rise or fall elsewhere can reverberate internationally – so sticking to a one dimensional approach to FX management could be costly.

Philippe Gelis is co-founder and CEO of the pioneering foreign exchange services provider, Kantox, established in 2011.

HOW DID WE ARRIVE AT AN ERA OF NEGATIVE INTEREST RATES AND WHERE ARE THEY LIKELY TO GO FROM HERE, ASKS BNY MELLON'S **MARVIN LOH**?

NOT WHAT THE RATE DOCTOR ORDERED

With great fanfare, the US Federal Reserve started to normalise monetary policy at the end of last year when it raised rates for the first time in almost a decade.

'Normalisation' is, of course, a relative term; despite the slight move higher in December, a Fed Funds target in the range of 25- to 50-bps remains in the realm of zero interest rate policy (ZIRP). That said, a positive US rate above zero would look downright generous to many observers compared to other global regions; many of which have pursued a negative interest rate policy (NIRP) in certain geographical regimes for almost two years

This monetary policy divergence is how we entered the year, with the Fed proposing several additional hikes during 2016, while the likes of numerous European policy makers and the Bank of Japan (BoJ) continue to signal their dovish intentions. True to form, many of the negative rate regimes have moved further into the "minus" territory, with the BoJ joining the party in February by introducing a negative policy rate for the first time.

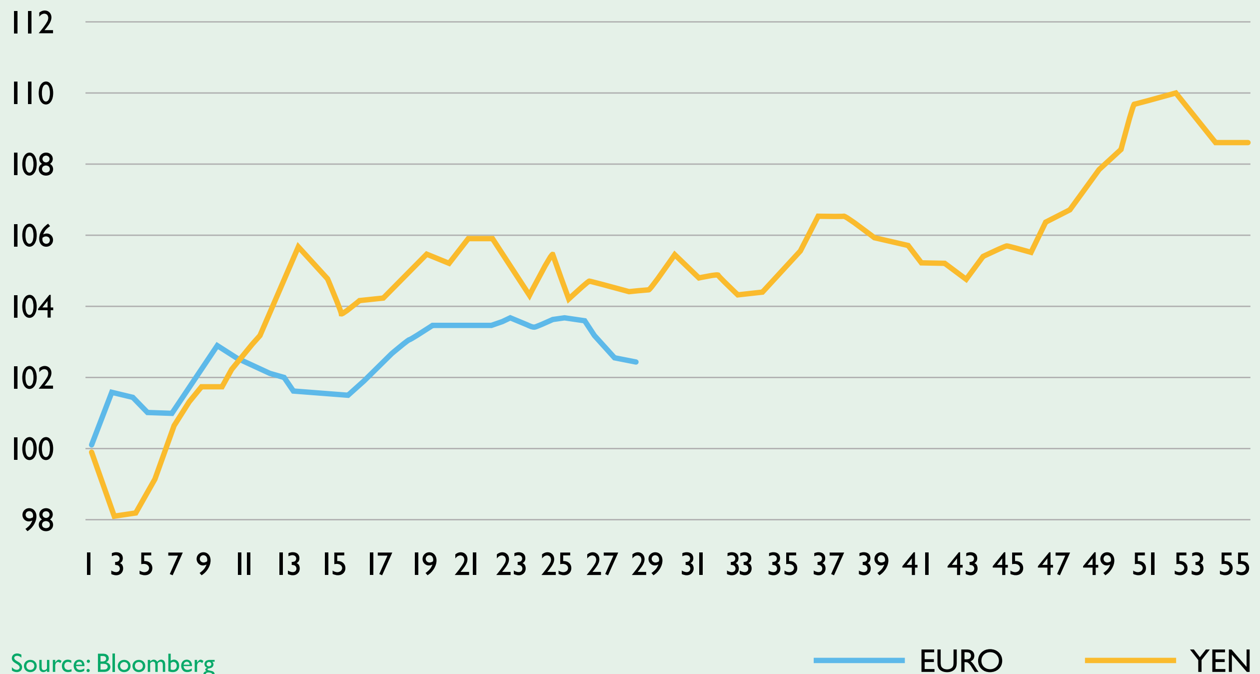
The Fed initially stood its ground, insisting that its late-2015 hike was not a mistake, and reaffirming its four-hike view for the year ahead at its January policy meeting. This proved short-lived, however, as the Fed could not stand by idly in the face of global volatility so it drastically slashed its rate hike expectations for the year. Simultaneously, it seems to have moved to an overall dovish tone.

Now let's look at what has happened during 2016. In reviewing the monetary policy changes implemented so far this year by the largest central banks, we'll begin in the US with the Fed. The Federal Open Markets Committee (FOMC) held the line during its January policy meeting maintaining its continued intent to gradually raise rates while also expressing concerns over global volatility.

For the market's part, after the January FOMC meeting volatility spiked through the middle of February before rallying sharply into the March 16 meeting. While the tone in risk assets improved, it appears the Fed nonetheless succumbed to the market's concerns, reducing its 2016 hike expectations from four to just two, while generally shifting towards a more dovish tone. Interestingly, this change of heart occurred while the Fed left its 2016 forecast for GDP, inflation and employment mostly unchanged.

For the European Central Bank's (ECB) part, it had ended 2015 by cutting the deposit rate to -30 bps while extending its bond buying programme for a further six months to March 2017 "or beyond".. The markets had expected more, and currency and equity volatility remained high after that decision. Nothing was expected in January, although the ECB did use the meeting to signal its readiness to move policy again shortly. As it transpired, the wait was not too long with the ECB announcing a range of measures during its March meeting, including another 10 bps reduction in rates to -40 bps; an expansion of its bond buying programme; and a series of loan programmes intended to stimulate lending in the eurozone.

Not to be outdone, in Japan the BoJ introduced negative yields - for the first time in its prolonged battle in fighting deflation while trying to break a history of sub-par growth. The BoJ lowered its policy rate by 10 bps to -10 basis points, with some caveats. Japan has always been a unique situation, given the already large existing level of bank reserves and high



Source: Bloomberg

savings rate. Since negative rates could harm the banking system and savers, BoJ created a tiered deposit scheme where less than 10% of existing deposits would be subject to negative rates, while the bulk continued to earn 10 basis points.

With negative or near-zero policy rates now common around the developed world, market yields have also routinely fallen to comparable levels. For instance, the Japanese government bond curve is presently negative out to seven years, Germany's Bunds curve is negative out to eight years, and Swiss government yields are negative to 15 years. Similar developments have occurred in France, the Netherlands, Belgium, Sweden and Norway; all now under the negative-yield regime, which is not expected to change anytime soon.

LIMITED OPTIONS

With slow growth and deflationary concerns continuing to challenge many developed markets, it is expected that central bankers will continue to use all of their policy tools to reverse these trends. However, as ZIRP has evolved to NIRP, and quantitative easing (QE) has become de rigueur, the number of available tools appears to have become dangerously depleted.

These concerns are also certainly not limited to the G-4, G-7 or G-10, as the title of the International Monetary Fund (IMF)'s recently published outlook - *Global Economy Faltering from Too Slow Growth for Too Long* - lays bare. The IMF's report lowers the 2016 global growth rate forecast to 3.2%. That reduction comes on the heels of an expected 1.9% growth rate for advanced economies, close to the lowest level for that rate since the advanced economies' emergence from the financial crisis.

Against this backdrop, it is reasonable to expect a further push into even more negative yield territory. The challenge has been that negative yields have not proven to be effective. For instance, the ECB entered the negative yield regime in 2014, but had a negative inflation reading in April and has been mired in the mid 1% growth rate for the past few years. The initial results of Japan's initial foray into negative yields are likely to have been a surprise to the BoJ, with the yen strengthening by 10% over recent months.

The ECB is also likely struggling with the same outcome - as the chart above indicates - with the euro recently trading near six-month highs, despite two rate cuts that took the deposit interest rate further into negative territory. Other anecdotal evidence shows investors resorting to a pattern of stockpiling cash. For example, the number of 10,000 yen notes grew by 6%in 2015, its largest increase in over a decade, and sales of safes have hit record levels in Japan.

The net result of these developments is that negative yields are being seen by many observers in a light of desperation; viewed as a move that central banks are taking when faced with no other options. It seems that the Fed is well aware of this perception and is looking at negative yields with a similarly sceptical eye. Their preference would be to avoid going down this route at all costs. Therefore, while further expansion into negative territory over the near term may not be an expectation, it is unlikely that there will be a quick reversal of the negative policies that have already been put in place.

Marvin Loh is managing director and global markets strategist for BNY Mellon.

IN THE RACE FOR THE WHITE HOUSE, THE US PRESIDENTIAL CANDIDATES' PROTECTIONIST RHETORIC COULD IMPERIL MULTINATIONALS BY RAMPING UP TRADE BARRIERS AND TANGLING GLOBAL SUPPLY CHAINS, WRITES **JOHN HINTZE**

PROGNOSIS FOR THE POST-OBAMA ERA

Never say never! The protectionist campaign rhetoric of US presidential candidates Bernie Sanders and especially Donald Trump has pushed other contenders in a similar direction, increasing the likelihood of new trade challenges for multinational corporations (MNCs) worldwide under the next president.

Hillary Clinton has reneged on her support for the Trans-Pacific Partnership (TPP), which the Obama administration has been negotiating with 11 other Pacific Rim countries, in the wake of Sanders' unexpectedly strong showing in the Democratic primary. Republican senator Ted Cruz is now adamantly opposed to the free trade agreement, contrary to the Republican party's longtime economic orthodoxy that he otherwise adheres to.

Once elected, politicians often leave behind protectionist threats voiced during campaigns. President Obama, for example, promised to open up the North American Free Trade Agreement (Nafta) to renegotiations but once elected quickly backed off that pledge, citing the global economic slowdown.

At times, however, such threats have impacted policies. Nearly 25 years ago, Independent candidate Ross Perot's "giant sucking sound"- his description of how Nafta would see an exodus of US jobs to Mexico - and the significant support he captured in the 1992 presidential is credited with introducing environmental and labour adjudication elements for the first time ever in trade agreements. Perot at times polled ahead of Bill Clinton and George H.W. Bush in the primary season and ended up with nearly 20% of the vote.

So far, Trump has been a similarly disruptive candidate. His threat of imposing 45% tariffs on Chinese products across the board appears to have attracted a sizeable and devoted minority of potential voters, with Sanders tapping a similar if less extreme vein on the left. Such protectionist rhetoric continuing through the election increases the likelihood that multinational corporations (MNCs) will face a range of challenges under the new president, whoever (s)he is.

"The political rhetoric now is extremely protectionist, and so it's not safe to say it won't have an impact after the election," says Emily Blanchard, associate professor at the Tuck School of Business at Dartmouth College.

Indeed, a significant portion of the US population now appears critical of trade policy that has driven both parties - particularly the Republicans - for many years. "Free trade, lower taxes, and no tariffs have been core to Republican ideology for decades," says Mindy Herzfeld, a contributing editor at Tax Analysts and formerly a senior manager at Deloitte Tax LLP. "Trump is rejecting all that, and much of the Republican base seems to be buying into his views." She notes Sanders' criticism of free trade as well. "The candidates seem to be shifting both parties away from free trade principles, and that could have serious ramifications."

Given a scenario where President Trump was able to institute significant tariffs, MNCs would almost certainly see supply chains disrupted, prices skyrocket, and sales plummet. Some tariffs remain today on countries outside regions with which the

US has established free-trade agreements, but they are very low; typically 5% or less. Tariffs are regulated by the World Trade Organisation (WTO), and any US violation of its commitments could undermine the institution itself, says Blanchard.

The outcomes range from bad to an outright trade nightmare. "The US can comply with WTO's decision - or not comply and pay huge fines," says Sharyn O'Halloran, a professor of political economy and international and public affairs at Columbia University. "Or it can ignore the fine and have other countries retaliate."

Even if no countries retaliated, it would still be bad news for US consumers and companies, says Blanchard. More than half of US imports are intra-firm, and in some manufacturing industries as much as half the inputs, or components, to produce final goods come from abroad. "Much of what is imported is vital production inputs that will be combined with US workers' labour, knowledge and production facilities to create products that will be sold here or exported," she adds.

Foreign suppliers of US companies would see their sales plummet, while the losses would not be limited to US MNCs alone - on average among G20 countries, roughly a third of all manufacturing output consists of foreign "value added" - inputs sourced through global value chains. Blanchard notes that these global supply networks bring together bits of specialisation and know-how that allow firms to produce complex products. This, in turn, allows different countries to harness their comparative advantage; focusing on those parts of global production they do best at doing. A significant jump in tariffs has the potential to disrupt the whole system, with uncertain implications for the trading system and potentially extending the impact beyond trade.

"We could lose commitments from other countries on a huge range of issues, from investment protections to safety standards to custom regulations," says Blanchard "You don't get to pick and choose. When you start violating agreements, it's the Wild West."

Sanders has been careful to emphasise that he wouldn't break any current trade agreements, but rather seek modifications or other means. That's probably wise, given the bulk of legislators' constituents would oppose them.

"The likelihood of getting a movement to increase tariffs is very low, because consumers would see the price on imported goods go up and they would oppose them," says Barry Bosworth, a senior fellow of economic studies at the Brookings Institute. He notes that support for Trump's and Sanders' protectionist rhetoric comes from a limited portion of the US population - predominantly native whites and African Americans with little higher education.

Bosworth notes that most Americans have benefitted from free trade's lower prices and wider job opportunities as markets have expanded abroad. While claims of another country's unfair trade practices might attract some support, the production of the goods in question would more likely shift to another low-wage country rather than return to the US. "The global economy is a fact and so hard to reverse," he adds.

O'Halloran agrees that tariffs are unlikely, but cautions that other regulatory measures could be taken, such as imposing sanitary standards that, for example, require lettuce imported from Mexico - a member of Nafta - to be washed numerous times.

"Those are the kinds of things you would anticipate happening, and they would just become more contentious," she says, adding that even those more targeted measures are a two-edged sword. For example moves to reduce foreign competition for a domestic sock maker could also increase the price of its

cotton imports.

Bosworth also believes the odds are against the US significantly increasing such measures, arguing that regulators are largely under the thumb of the industries they regulate. Nevertheless, politics can lead in unanticipated directions. Should Trump or Sanders win the presidency, Congress might interpret it as a mandate to take at least some measures to return production from low-wage countries.

Harry Moser, founder of the Reshoring Initiative - which promotes bringing production back from overseas to the US - argues that there are several less contentious measures that could be taken to lower the trade deficit and bring back manufacturing. They include training a larger and more skilled workforce, instituting a value added tax, lowering the corporate tax rate to 22% while removing loopholes, reducing the value of the US dollar, and educating companies to source based on total cost, instead of wage rates or price. Moser refers to such measures as "leveling the playing field" with other countries, adding, "If the playing field is level, then protectionism isn't necessary."

As companies bring production back to the US, gaps in supply chains that are currently filled with imported goods should increasingly be replaced by those produced domestically. The resulting benefits would include more well-paid jobs, increased government tax revenue, and the resulting lower trade and budget deficits. Although the cost of goods could edge higher, Moser says that history suggests the increase is relatively modest. The same would apply to other countries adopting similar policies, he adds, although factories in China tend to have more regional supply chains already.

Taking protectionist measures could speed up this process, essentially forcing companies to plug supply-chain gaps with domestic goods sooner. However in the short term supply chains would likely be disrupted, resulting in price jumps for consumers and companies.

On the campaign trail, Sanders strongly expresses support for keeping jobs in the US and his opposition to TPP, adding that he also opposed Nafta. Yet he has yet to provide detail on just how he would galvanise the US jobs market, apart from his proposal to make public universities free. That expands the Obama administration's push for free community colleges, which have historically offered courses seeking to meet local demand for skills - one of the critical measures promoted by the Reshoring Initiative.

Unfortunately, any such proposal is likely to be strongly opposed by Republicans, who immediately rebuffed the Obama administration's proposal. Bosworth notes that job-training programmes, historically financed locally, have virtually disappeared and even unions no longer support them. In fact, he says, Republicans have made significant cuts to public education, just when Americans need more education to compete and not less.

Meanwhile, Senator Ted Cruz expresses support for a VAT-type tax, and both Republican candidates have promoted lowering corporate taxes to around 15%. Trump has accused China of purposefully weakening the renminbi, and so presumably he would take steps to weaken the dollar relative to that currency. If Democrats hold on to the presidency and Republicans at least one legislative body, it seems unlikely any of these non-tariff measures would come to fruition, and protectionist sentiments would continue to boil.

Moser's conclusion is downbeat. "Not much is being done in terms of creating a more skilled workforce, incorporating a VAT, or lowering corporate income taxes, so it increases the likelihood we will at some point get protectionist measures." ■

AS COMPANIES BRING PRODUCTION BACK TO THE US, GAPS IN SUPPLY CHAINS THAT ARE CURRENTLY FILLED WITH IMPORTED GOODS SHOULD INCREASINGLY BE REPLACED BY THOSE PRODUCED DOMESTICALLY

CAPTIVES UNDER SOLVENCY II

THE NEW EU REGULATORY REGIME DRIVES A DEEPER UNDERSTANDING OF RISK FOR CAPTIVE OWNERS, REPORTS DEREK BRIDGEMAN

After over a decade of deliberation, debate, and a lengthy implementation period, Solvency II finally arrived in the European Union on 1 January 2016. Despite the failure to secure a separate carve-out for captives, EU captive owners and service providers are, in the main, embracing Solvency II with positivity and optimism. With regards to the impact on the global captive market, fears that there would be a fall-off in onshore EU captives post-Solvency II have proven to be ill-founded. Indeed, many now anticipate that growth in the number of captives with the EU domiciles will increase, and that the EU captive market will become one of the more sophisticated markets over time.

Initial fears around Solvency II for captive owners were based on the thinking that captives do not fit easily into the traditional commercial insurer model, for which the regulations were essentially designed. A captive insurance company is a licensed insurance or reinsurance company owned by a non-insurance company, which insures the risks of its parent or affiliated companies. Simply put, it is a formalised mechanism to finance self-insured risks. Companies that establish captive subsidiaries have traditionally been sizeable operations with large risk exposures, seeking to gain improved control of their risks. The captive market operates in a complementary manner to the commercial insurance market, but captives differ from commercial insurers in several fundamental ways.

WHAT IS DIFFERENT ABOUT CAPTIVES?

- Investment strategy is traditionally limited to a small number of assets.
- Captives are specialist underwriters, whose risks are limited to those of their owners.
- Many of the operational processes are outsourced; thus those processes differ from those of the traditional market.

Often called "Basel for insurers", Solvency II is somewhat similar to the banking regulations of Basel II. In response to the credit crisis, the Basel Committee published revised global standards, now known as Basel III. When revising the Basel framework, it was decided to also update the Solvency framework. The new regime has been in the making for over a decade and was finally implemented at the start of 2016. The move from the formulaic Solvency I system to the realistic and risk-based Solvency II system has resulted in significant new requirements for all European insurers, including those within the captive community.

Again, similar to the Basel framework, Solvency II takes a three pillar approach:

- Pillar 1 covers the capability of an insurer to demonstrate that it has adequate financial resources in place to meet all its liabilities and consists of the quantitative requirements, such as the amount of capital an insurer should hold.
- Pillar 2 sets out requirements for the governance and risk management framework that identify and measure the risk against which capital must be held, as well as for the effective supervision of insurers.
- Pillar 3 focuses on disclosure, reporting, and transparency requirements

around these risks and capital requirements.

The Quantitative Impact Study 5 (QIS5) in 2010 was the first time that most captives considered their Solvency II capital requirement. There have been various changes in the requirements, with simplifications now permitted in certain areas. It is, however, generally accepted that the requirements are mostly stable and what we have now is what we will move with through the early years of implementation.

FLEXIBILITY AND PRUDENCE

Some key changes for captives under the new regime have been the call for higher capital requirements, enhanced governance and internal control procedures, together with additional supervisory and public disclosure.

Paradoxically, the fact that Solvency II requires an effective marking-to-market of both asset and liability sides of the balance sheet, means that the solvency capital ratio (SCR) - which will become a key metric used in comparing companies' financial strength - is likely to become more volatile, with the weightings enforced for varying exposures potentially having a more material impact. The need for captives to re-evaluate the use of capital and explore new investment opportunities, among others, has inevitably led to additional expense. While there are additional investments necessary, there are also substantial benefits that companies can achieve.

In contrast to the previous regime, Solvency II provides greater flexibility around captive investment strategy. The most engaged owners are revisiting their investment strategy to potentially reduce SII capital requirement. Additionally, companies are exploring potentially more efficient sources of capital, such as ancillary own funds. Where a captive parent is rated BBB or higher, intercompany lending back to the parent can be advantageous from a group perspective and provides an option which was not broadly or consistently available under the Solvency I regime.

The directors responsible for captives must demonstrate that the prudent person principle has been applied, with the emphasis on demonstrating that assets have been invested in a "prudent" manner. Often the difficulty for the board will be assessing whether they are "maximising the rate of return while also acting in the best interests of the policyholders".

A prime example here would be the high penal charge associated with investment in equities under Solvency II. Although investors have enjoyed favourable rates of return on equity investments in recent times, this benefit can be somewhat offset by the higher capital charges. The expectation within the industry is that there will be a shift from the traditional "return on volatility" analysis to a "return on regulatory capital" with the inevitability of increased offerings of Solvency II-compliant bonds and managed accounts by investment firms.

Solvency II demands that directors demonstrate an understanding of risks and drivers and the related impact on their Solvency II position. The forward looking assessment of own risk (FLAOR)/own risk solvency assessment (ORSA) exercise has allowed the board to see the alignment of Pillars 1 and 2 and the resulting impact on the Solvency II capital charge. This engagement will assist in embedding more of a top down decision-making approach, in line with Solvency II demands.

Engaged captive owners have taken on board the fact that an increased

knowledge of the capital cost implications of board decisions is required, in areas such as insurance programme structure, counterparty ratings, and diversification for both investments and reinsurance. Where companies have encountered a potential issue with their solvency capital requirement (SCR) in the preparatory phase, the expectation is that owners will continue to explore potential methods of improving the capital efficiency.

Owners are also likely to explore alternative forms of capital (Tier 2/3 capital) in order to strengthen their capital base. The use of letters of credit (L/C), parental guarantees, subordinated debt and unpaid share capital are options which will inevitably be explored further. This is seen as a benefit of Solvency II, as traditionally the equity of a captive would have been financed in the form of fully paid-up share capital or capital contributions.

LOOKING AHEAD

For companies with capital levels well above the SCR, the results of the FLAOR/ORSA have - in certain cases - highlighted a very conservative current risk appetite. In such instances, this has led to increased retention levels or expanded business - perhaps into other classes of business, or into new geographic territories.

As we move forward, owners must ensure that the ORSA is embedded within the company structure and that there are realistic and robust stresses and scenarios tested. Recent regulator feedback has highlighted three areas: firstly there must be sufficient board challenge, secondly risks which are difficult to quantify (group and operational risk for example) must not be ignored, and lastly the ORSA must be sufficiently forward-looking, with time horizons of less than two years insufficient. In practice, we have seen clients use planning horizons of three to five years.

Although Solvency II is designed to achieve maximum harmonisation, it is acknowledged that inevitable jurisdictional differences are likely to emerge; at least over the short-term. Captives must strive to ensure that, in line with the nature, scale and complexity of the entity, the principle of proportionality is applied. A key area where attention will be focused in 2016 will be the individual approach on implementation, which will be adopted by national regulators. As both regulators and companies move through implementation, the challenge will be to ensure that the Solvency II process is made more refined, as opposed to complex.

At a more detailed implementation level there are several areas where greater guidance and clarity is needed before the full impact of several aspects of the new regime can be assessed. Examples here include items such as the treatment of deferred tax assets (DTA), the regulatory response to new investment and capital forms not expressly considered in the legislation as adopted, and indeed the precise approach to equivalency or non-equivalency in key jurisdictions outside the EU. There have been examples of large captives within non-Solvency II jurisdictions opting to use the Solvency II SCR drive their capital requirements in order to gain a competitive advantage.

Now that captive owners are fully familiar with the new regime - and through the ORSA process have become more sophisticated in their thinking around capital utilisation and investment return - we are also likely to see a broader integration of captives into the risk management and enterprise risk techniques of their parent groups. With the pursuit of capital efficiency, we anticipate seeing an increase in diversification of captive risks - beyond the traditional areas of property and casualty, into non-traditional areas such as employee benefits, supply chain, and cyber risk.

At Marsh, the group's risk finance optimisation (RFO) methodology uses data and analytics to enable captive owners make accurate decisions about how much insurance risk to retain and how much to transfer (i.e. optimum balance between less formal self-insurance, captive utilisation, and the external insurance market). Stochastic analysis can calculate potential volatility for each insurance risk and provide simulated results with various retention structures.

This output is combined with indicative insurance market pricing and your "weighted average cost of capital" (WACC) in order to determine the optimal risk finance structure. The corollary of this analysis is to enable captive owners and decision-makers to consider new and alternative potential uses, to enhance the value of the captive to the parent and optimise the use of capital and resources.

CHALLENGING TIMES

2016 will present a critical year for all captive owners; particularly around Pillar 3 reporting, with regulator feedback to date emphasising that increasing the transparency of the insurance industry is seen as a key outcome of Solvency II. It remains to be seen if and how the principle of proportionality will be applied to captives throughout the Pillar 3 requirements of the directive.

Obviously there are differing opinions across the industry, however, much feedback indicates that captives often view the higher costs from upgrading risk management and governance as offset by the benefits that a better understanding of their risk profile provides. In the longer term, Solvency II is viewed by many as a positive development for captives as stronger risk management capabilities will provide greater value to their parent companies.

Not only is there a desire to achieve commonality in approach across all countries, but additionally the extent to which principles of proportionality will be applied by individual states will be closely followed. Many feel there is a need for all national regulators to develop and publish their interpretation of the principle of proportionality, to help further achieve the intended harmonisation goals of Solvency II.

We feel that owners recognise the opportunity to be smarter in their utilisation of captives and therefore anticipate there will be a greater call for the services of captive managers and advisers as boards address evolving aspects of the SCR calculations and focus further on a fully integrated service solution across all three Solvency II pillars.

Derek Bridgeman is Solvency II project lead for Marsh Captive Management

AS WE MOVE FORWARD, OWNERS MUST ENSURE THAT THE ORSA IS EMBEDDED WITHIN THE COMPANY STRUCTURE AND THAT THERE ARE REALISTIC AND ROBUST STRESSES AND SCENARIOS TESTED

ACHIPITA IS A GREEK COMPANY HEADQUARTERED NEAR ATHENS WHICH PRODUCES SAVOURY SNACKS AND HAS A WORKFORCE OF OVER 10,000 PEOPLE. CHIPITA WAS OWNED BY VIVARTIA UNTIL A DEMERGER IN 2010. MARIANNA POLYKRATI, FORMERLY GROUP TREASURER OF VIVARTIA, WAS APPOINTED CHIPITA'S GROUP TREASURER IN 2013

MANAGING TREASURY IN GREECE

BY REBECCA BRACE

Could you tell me about your company and its international footprint?

We are among the last Greek multinational companies. Our headquarters is in Greece, but our presence is mainly outside the country, with around 85% of revenues coming from outside the Greek market. We produce flour-based snacks and around 70% of our total revenue comes from our main product, which is a packaged croissant. Our revenues are around €450m per year.

Our companies are located in 11 different countries and our products are sold in 66 countries. Our main area of focus is the Central and Eastern Europe (CEE) market and in this region we have factories in Bulgaria, Poland and Romania. These plants serve the commercial companies located in the Czech Republic, Germany, Hungary, Slovakia and Serbia.

In the Commonwealth of Independent States (CIS) region, we have a factory in St Petersburg, serving the Russian market and the commercial companies in Ukraine and Belarus. We are in the final stages of opening new commercial companies in Kazakhstan, the UK and in Lithuania. We have entered, via the establishment of new factories, the Turkish and Indian market while we have joint ventures in Mexico, Saudi Arabia and Egypt.

Each of these countries has its own local management team, but the treasury function is done centrally - so everything relating to bank relationships, liquidity and financing comes from the headquarters here in Greece. My purpose and target is to try and collect all the excess liquidity from the subsidiaries to the HQ, through all possible methods.

How have economic conditions in Greece affected your sector over the past few years?

Between 2010 and 2013, the Greek market conditions were not positive - but in the summer of 2014, companies working with food and production in the retail market could see that the Greek market was picking up. I guess that this boost was also the main reason that most Greek companies made it through the lock-up period of the banks in the summer of 2015. Following the elections in January 2015, last year was a long standby period with everyone waiting to see what would happen. Since then, there are signs that the market hasn't really picked up.

The Greek market is heavily taxed. In our company's case, the VAT rate has increased from 13% to 23%, and we have had to absorb most of the increase ourselves, with only a very small percentage passed on to the consumer. Meanwhile, changes such as higher personal tax rates are contributing to a reduction in consumer spending.

We still have our first factory in Greece, which is where we do all the research and development activity of the group,

developing and testing new products. Unfortunately, Greece doesn't export any more - it stopped exporting in April 2014. Just to show the differences in the operating costs of the Greek factory with the same ones outside of Greece, the cost of power in our Bulgarian factory is around one third of the cost in Greece. For most production companies, electricity represents a large percentage of its total cost - so this plays a very important part in the final cost of the product.

How much of a challenge is it for Greek companies to access financing in the current market?

Accessing liquidity from the Greek market is a significant challenge. Where bank financing is concerned, the tap still has not been opened and there are only very scarce amounts of finance that are being put into the Greek companies operating in the market. At the same time, financing in Greece is quite expensive; I would say that very good companies here might have a financing cost of around 5.5%, compared to 3.5% in other countries.

Some of the larger Greek companies have transferred their headquarters to other countries - mainly for tax and financing purposes, such as the Netherlands - where they may be able to access the financing they need. It should be noted that even when Greek companies have a mostly international presence, they are considered by foreign financial institutions and investors as high risk due to the "Greek risk" if they have their headquarters in this country.

For funding purposes, a lot of companies are also selling their silverware - they are making small divestments of the companies that are not considered to be their core business in order to raise the cash needed to maintain their obligations.

As far as we are concerned, we have access to financing - but having Greek headquarters does create a lot of constraints when it comes to dealing with banks outside the country. Although our business in Greece is less than half of our total sales, the fact that our headquarters is in Greece is still seen as a risk factor by the foreign banks.

What other challenges are treasurers in Greece currently facing?

For one thing, it is very difficult to prepare a budget and make a forecast for the coming year – particularly due to the lack of a stable tax environment. There are many changes that happen suddenly and abruptly, and which can affect the timing of a group's strategies throughout the year. For example, increasing the tax rate from 26% to 29% could have a very large impact. Another example is changes in the social security contribution rates.

In addition, it is difficult making payments outside of Greece with the capital controls that are still in place. We have managed to surpass this because we have three different payment centres - so as well as having accounts with all the large banks in Greece, we also have bank accounts outside of the country. All our flows outside of Greece go through these accounts, and we try to match payables and receivables that are coming from the same locations.

The benefit of working for a Greek company with a largely international presence is that you can focus upon growth and development, while finding ways to overcome the liquidity difficulties and issues arising from the Greek market.

How do you approach liquidity management?

Our business operates in three different types of market. The first are the very mature markets, which tend to have a surplus cash flow - these include Bulgaria, Romania and Poland. The second are stable markets where we do not need any financing, such as Russia and Greece. Then we have new markets where we have recently established operations and where we need additional working capital financing to support new investments.

We forecast all the cash flows for the year and find the best way to bring up the flows from the operational entities with excess cash flow up to a collecting entity, which is the financing company for the group. From there, we deploy excess liquidity for group expenses, working capital investment in the other companies, or wherever the cash is needed. Last year we focused a lot on putting a system in place for forecasting the group's cash flows. This year we will be building on this project in order to set up an active rolling forward forecasting system.

What about managing FX exposures?

We work with many different currencies and therefore have to manage a lot of FX fluctuations. The rouble in particular has had very sharp fluctuations during recent months. We also work with currencies such as the Indian rupee, Romanian lei and the Polish zloty.

We generally try to use natural hedges for our FX exposures - around 85% of our raw material purchases are done in local currencies and these purchases are pretty well matched against our receivables in those currencies. Whatever differences we have are financed by borrowing in the local currency.

Do you have any new projects in the pipeline for this year?

Yes, we're currently looking at implementing a treasury management system. We've investigated the systems available in the market and have come up with three or four different solutions which could meet our needs.

First of all, we want to have a platform where we can have all our bank account balances and statements on a daily basis. We also want to be able to have the forecasting inside this tool - and to have our payment centres on the same platform so that we can have an overview of all the group's payments.

What skills do treasurers in Greece need to overcome the various challenges?

You have to be very flexible. You also need to have very good communication skills, because there are so many issues that relate to the different departments of the group. When you have strong communication with a procurement team, for example, you can put in place a very precise cash flow forecast because you know their needs and they can make an accurate estimate of what they are doing. The same applies to the finance department.

Finally, you need to realise that there is always a solution to every problem. You have to work like a problem solver all the time, which means being very organised and gathering all the facts in order to find all the possible solutions ■

ACCESSING LIQUIDITY FROM THE GREEK MARKET IS A SIGNIFICANT CHALLENGE. WHERE BANK FINANCING IS CONCERNED, THE TAP STILL HAS NOT BEEN OPENED AND THERE ARE ONLY VERY SCARCE AMOUNTS OF FINANCE THAT ARE BEING PUT INTO THE GREEK COMPANIES OPERATING IN THE MARKET

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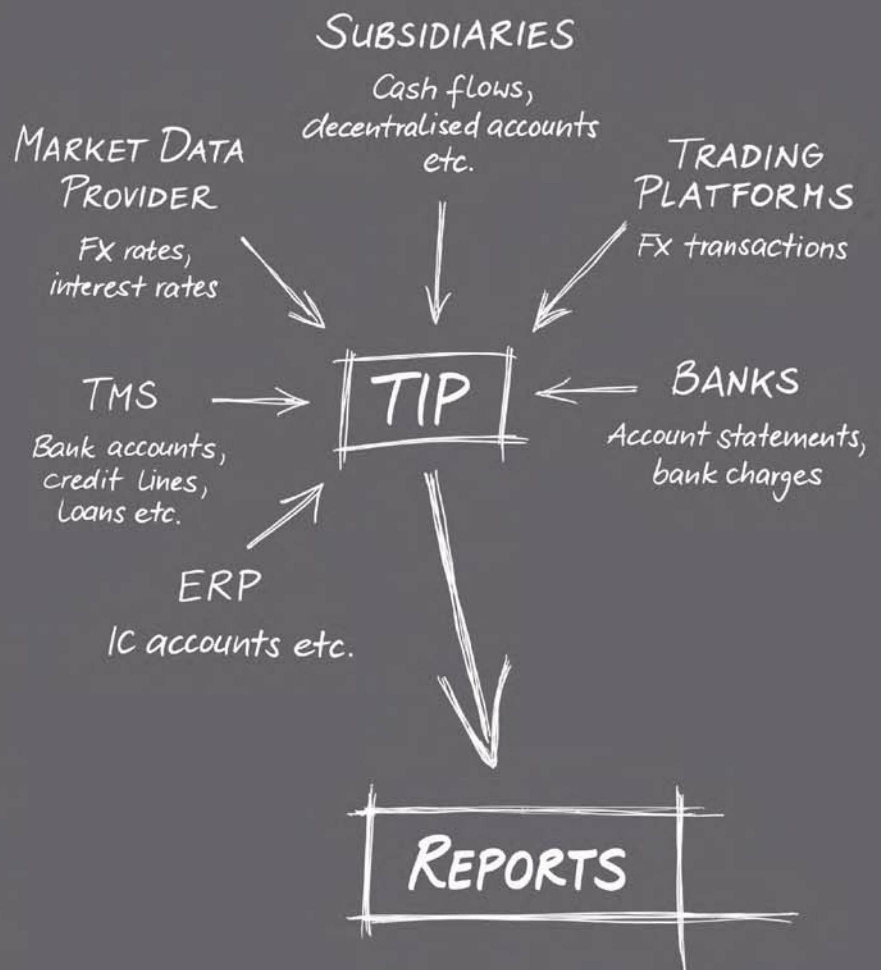

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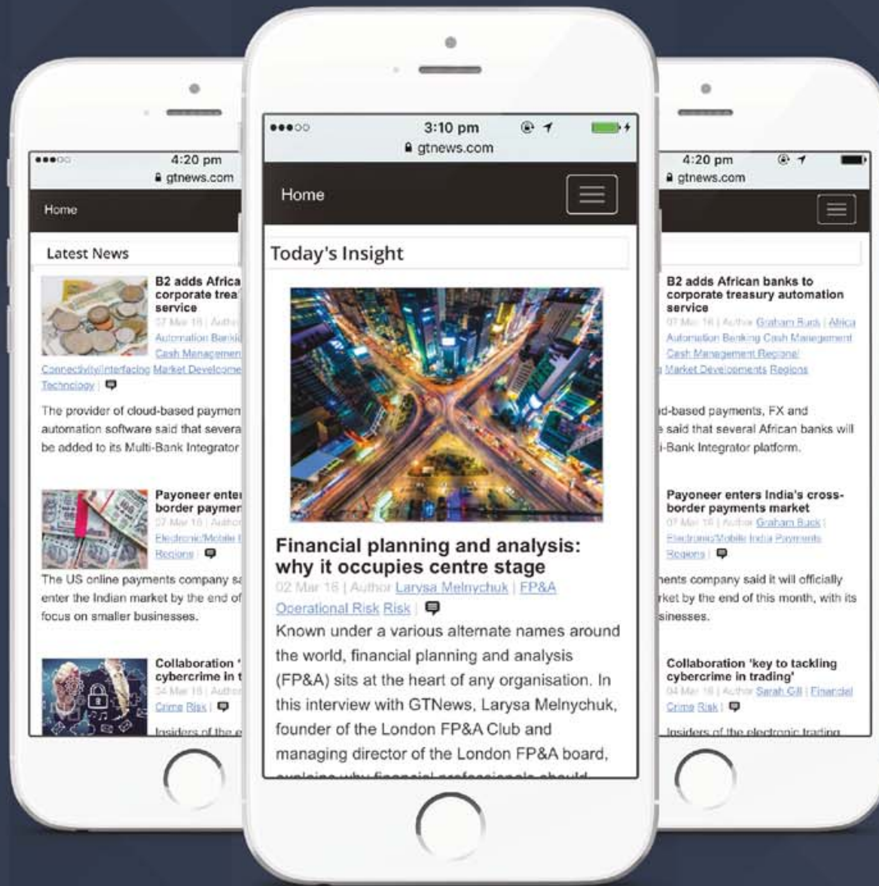

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