The Brave New World of Treasury

- Back to the 1960s?

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The Question

Treasury efficiency versus regulatory change: back to the future?

- The challenge of managing a global treasury in today's dynamic regulatory landscape – particularly its rapidly evolving tax reforms – is substantial. Regulation continues to increase the cost to banks of providing core corporate services: in mature markets, there is increased emphasis on making sure each local entity of a bank is fully capitalised and controlled locally, which puts extra pressure on banks maintaining international networks; global regulations are increasing the cost of risk management transactions and changing liquidity in key markets such as FX, leaving new players to fill the gap. What does this mean for treasury decision-making, strategies and structures?: full fat, onshore, local trading and treasury activities? And then there is BEPS: how will it affect cross-border supply chains and the treasury and cash management structures which have arisen on their back? Is a de-centralised, 1960s version of treasury the future?

Health Warning

- This presentation refers to political events
- It tries to assess the possible impact on treasury operations
- The intention is not to express a view on the politics
- Any views which unintentionally come through are my personal views
- They do not represent the views of any organisation with which I may be involved.

Agenda

- The world 10 years ago
- What is happening now?
  - Brexit and America First
  - BEPS
  - US Tax reform (?)
  - End of easy money (?)
  - Financial regulation
  - Exchange controls
- What will the future look like?
- Will all of this happen?
- What should treasurers do?

The World 10 Years Ago

1. NAFTA
2. EU
3. China
4. ASEAN

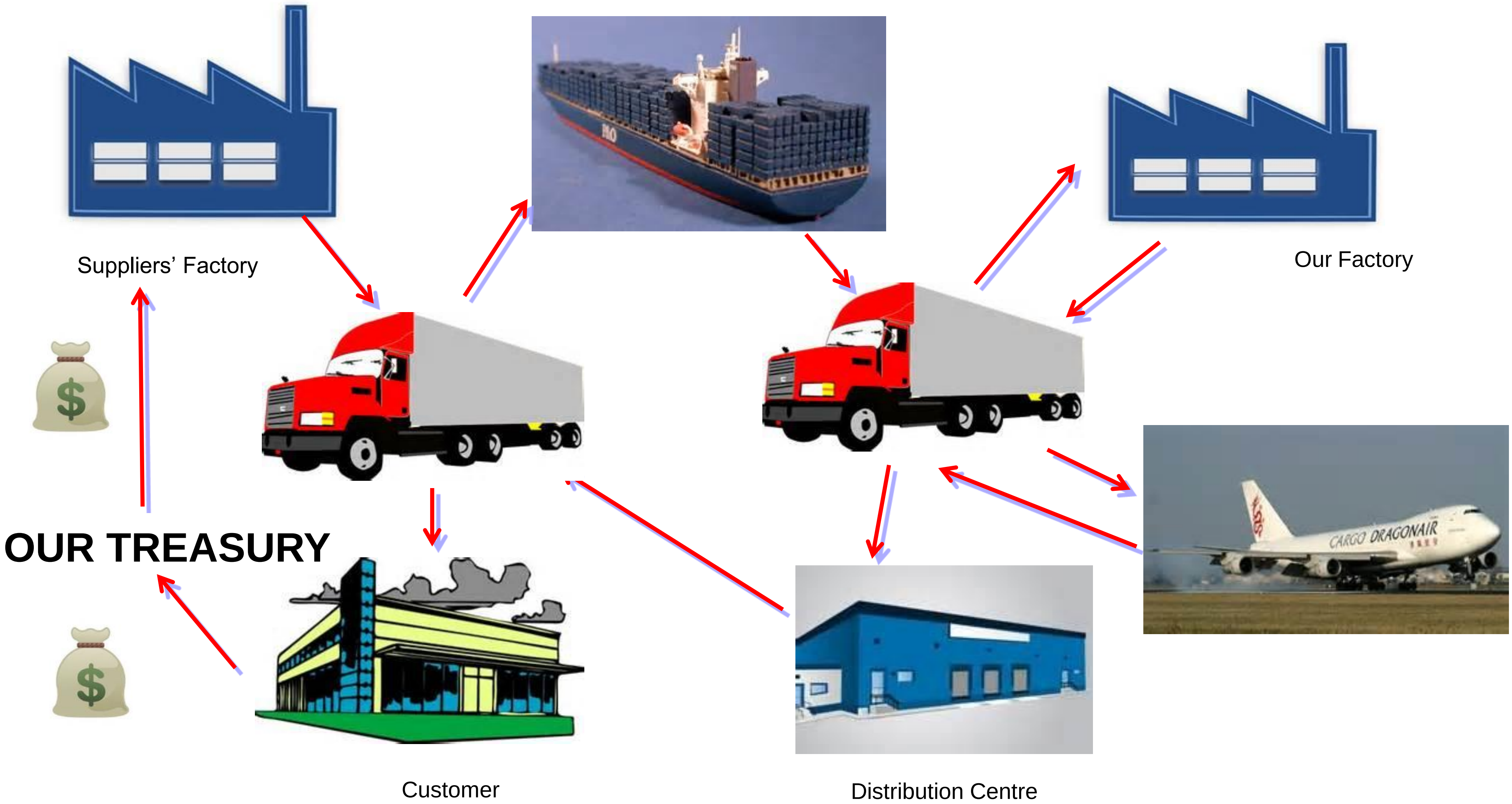
The Treasury World – Regional Centres

1. Americas

2. Europe

3. Asia/Pacific

A Typical Modern Supply Chain



The Treasury World

- Built on economic integration
- Usually, underlying cross border supply chains
- Frequently, tax benefits driving:
  - The activities of the treasury centre
  - But also the supply chain and the source of supply
- Features:
  - Cash pooling – at least within the region
  - Generally easy movement of funds across borders
  - Centralised funding and cash payments
  - Centralised hedging and FX management
  - Reduction in banking relationships – international banking
- Come to Eurofinance to hear how it is done!

What is Happening Now?

Brexit

America First!

- Asia – the (mostly discrete) return of exchange controls
- Reduced liquidity in FX markets
- Central banks: need to ensure solvency by country
- Tax: BEPS
- (Possible) US tax reform and repatriation
- (Possible) US and Euro rate hikes, unwinding of balance sheets
- Separatist pressures within countries: Scotland, Catalonia etc.

Base Erosion and Profit Sharing

- … or BEPS, for short
- Aim: stop artificial movement of profit to low tax countries
- Method:
  - Require publication of revenue, profit and tax paid by country
  - Highlight mismatches
  - Combination of public pressure and tax audits to equalise tax
- Possible consequence:
  - Removal of one benefit of international supply chains
  - Severely complicate transfer pricing
    - Split between manufacturing and distribution pofits
  - Link to the move to "bring jobs home"?
  - Could be a problem for some major treasury centre locations

US Tax Reform

- The US tax is on world wide revenue
- (Corporations') foreign profits taxed when repatriated
- Result:
  - US corporations usually do not remit back non-US profits
  - Huge cash balances build up outside the US ($2.5trn)
  - US corporations have to borrow in the US to pay dividends etc
- Financial market impacts:
  - Significant flow of liquidity into Europe, Asia
  - Development of corporate bond market in US (and outside)
- What will happen to the markets if this reverses?
  - US: possible reduction in leverage – share repurchases more likely
  - Outside US: funding and credit squeeze

Rate Hikes, Unwinding QE

- A decade of zero interest rates
- QE: central banks' balance sheets ballooning
  - US Federal Reserve $4.5trn
  - ECB "buying the market"
- What has the impact been?
  - Easy – and cheap funding
  - Expansion of corporate bond issues
  - Massive flow of liquidity to Asia – and asset bubbles
  - USD bond markets developing around the world
  - EUR bond market beginning to develop in Asia
- What happens when this reverses?
  - Possible crash in asset prices
  - Funding squeeze – may have to "go local"

Banking Regulations

- Global Financial Crisis:
  - (Officially) Banks rescued with taxpayers' money
  - Politicians' promise: "never again!"
- Result: Basel III, Dodd-Frank, MIFID, etc
  - Each national regulator protects national taxpayers
  - Result: each bank has to show solvency for each country
  - Each loan attracts regulatory capital charges in country
- Also (slightly related): FATCA
  - Result: need to be careful when dealing with US entities
- Impact:
  - Banks have to manage the client by country
  - Full cross border treasury management may get harder.

Exchange Controls

- China: unofficially, nothing has changed
  - In practice, implementation of rules much stricter
  - New rules put in place
  - Cross border cash pooling suspended or restricted
  - Outbound M&A restricted
  - Rules being relaxed again, as currency under less pressure
- Indonesia requires onshore hedging
- Malaysia recently moved to shut down offshore NDF market
- For Asia, not surprising – reflects economic performance
- But what about the rest of the world?
  - Greece is still restricting outwards remittances – of the euro!
  - What about other weak economies in the EU?

Where is this Leading?

- Reduction of cross border trade
  - Through tariffs and tax legislation
- Need to do funding on a country by country basis
- Funding – huge pools of cross border liquidity disappear
- Return of exchange controls
- Stricter controls over cross border movement of people
- Sound familiar?
  - Yes, to anyone aged over 50.
- The new world of treasury may look distressingly familiar

The Future of Treasury Management?

acts
WHERE THE BEST TREASURY MINDS MEET

What is this World Like

- For those who may have forgotten:
  - Much bigger staffs – treasury team in each country
  - Less efficient cash management – harder to pool
  - Many more banking relationships
    - For local funding
    - International banks less able to compete
  - Currency hedging potentially more complicated
  - Potential issues with trapped cash
    - More exchange controls
    - Disappearance of cross border supply chains
- There is a reason why we moved away from this!

Will it Happen?

- Probably not
  - Brexit is not going well
  - The US administration seems to be struggling to pass its agenda
- More important:
  - Today's connected world makes it difficult to go back 50 years
  - The economic benefits of globalisation have been debated
    - But overall, is probably positive
- And there were always likely to be speed bumps
  - Dislocation, jobs moving, winners and losers
- Are they just speed bumps, or a real end to the process?

What should Treasurers Do?

1. Do not assume this is impossible
   - Unlikely and impossible are not the same
2. Be prepared:
   - Try to avoid excessive leverage
   - Cultivate banking relationships across the regions
   - Look to involve local finance teams, if they are not involved
3. Communicate with regulators
   - Via national treasury associations
4. Understand the concerns:
   - Globalisation brings losers, as well as winners
   - Corporates need to be more sensitive to this

Thank You

Backup

Europe in 2000

Europe in 1600