Risk!

Association for Financial Professionals®
AFP—Your Daily Resource

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In the November *Risk*

There's plenty of foreign currency thought leadership this issue, as Andy Gage of FiREapps looks at reducing the EPS impact of currency volatility while John Hintze reports on the Chinese renminbi and the Indian rupee. Also, Sheila Bair spoke at AFP's Annual Conference in Las Vegas on regulatory and political risk—and she had plenty to say, as usual!

Reducing the EPS Impact of Currency Volatility

Andy Gage

As multinational corporations of all sizes look to emerging markets for growth, they are more exposed to a greater number of more volatile currencies. For companies not managing those exposures, the volatility is increasingly hitting their earnings per share. In the first half of 2013, the average EPS impact of currency volatility was $.03. That is more than three times higher than the industry benchmark of less than $.01.

So how can multinational corporations manage risk? To hedge or not to hedge is not the question. Instead, it is about optimizing the currency risk management program—and continuously improving it.

To optimize the currency risk management process, MNCs should:

1. Get an accurate, complete and timely understanding of their exposure across all of the currency pairs they do business in
2. Based on that total view of exposure, quantify the risk
3. Decide if that risk is acceptable. If it is, continue to monitor and repeat steps 1-3
4. If the level of risk is not acceptable, decide together (Board, CEO, CFO, treasurer) what tactics to implement to manage the risk
5. Using accurate, complete and timely understanding of exposures across all the currency pairs the MNC does business in, execute the risk management tactics efficiently and effectively
6. Repeat Steps 1-5.

Difficult but it need not be

In a multicurrency environment, it is often difficult to gain and maintain an accurate, complete, and timely understanding of your exposure across all of the currency pairs you do business in. That was certainly the case for Cabot Corp., a specialty chemicals and performance materials company with operations on nearly every continent.

Cabot uses JD Edwards as its enterprise resource planning (ERP) system. While JD Edwards has multicurrency functionality, that functionality was not consistently used across the organization. As a result, data coming out of the ERP did not accurately reflect Cabot's complete currency exposure.

In addition, the data that treasury needed was not timely. To determine Cabot's currency exposure, 100 summary spreadsheets were submitted to the treasury team monthly for manual consolidation to develop hedging recommendations. Fully 170 person hours went into estimating the company's FX exposure using source data that was already two weeks old. These challenges are by no means unique to Cabot and JD Edwards; we see these issues impeding treasury at every company we engage with.

Cabot worked with FiREapps and now its treasury team can see its exposures across every currency pair, in real time. The cross-functional effort to implement timely and effective multicurrency accounting was spearheaded by the treasury team but required full support and collaboration from accounting and business-unit finance to eliminate the risk of bad data at the source. The result was financial operational excellence across the organization and the ability for the treasury team to be more strategic in managing currency risk organically.

"As a global company, currency can significantly impact our EPS," said Cabot CFO Eddie Cordeiro. "We now have the policies, processes, automation and intelligence we need to more effectively manage foreign exchange exposures. In this market, that's not a nice-to-have. It's a must have."

Besides better risk management, Cabot eliminated 63 percent of its exposure internally, eliminated the associated transaction costs and realized over $1 million in annual savings. The company now keeps FX impacts down from as much as $.06 EPS to within the industry benchmark of less than $.01 EPS. And with their newfound understanding of their full portfolio of currency risks they are on track to eliminate an additional $575,000 in annual costs.

Cabot's story illustrates the common experience of multinationals before and after optimizing their currency risk management programs. Before, idiosyncrasies in how the ERP system was set up and used made it nearly impossible for Cabot to fully understand its currency exposures. That meant Cabot was spending money on hedges it did not really need and spending many hours each month to estimate its exposures. ▲

Andy Gage is the Vice President of Strategic Market Development at FiREapps

Ex-FDIC Chief Sheila Bair to Congress: 'Get Your Act Together'

Graham Buck

LAS VEGAS – Foreign nations are watching the United State very carefully for signs of increased volatility and uncertainty, said former regulator Sheila Bair.

Speaking at the recent AFP conference, Bair, the former chairman of the Federal Deposit Insurance Corporation, made those remarks after a recent trip to Malaysia. "They're very anxious about the current [political and fiscal] situation in the U.S. and also appalled by the spectacle of Congress squabbling over the debt ceiling," she said. "Let's hope that Congress can now redeem itself and start doing its job."

Bair's experiences as one of the main players in efforts to repair the economy in 2008, are recounted in her recent bestseller, entitled "Bull by the Horns." She noted that the words of Confucius aptly described the lessons of the crisis: "Study the past if you would define the future."

Five years on from the crisis, the flaws of Basel II—implemented in 2004—were all too obvious, particularly the assumption that banks were sophisticated enough to calculate the riskiness of their assets. "Fortunately that was an attitude that the FDIC was already resisting before I joined," Bair said.

Added to this were the fundamental mistakes of the government permitting excessive leverage to maintain economic growth and the deterioration in lending standards over the period leading up to the 2008 financial near-meltdown. "The Federal Reserve refused to set lending standards as it didn't want to restrain the market," Bair added. The regulation of derivatives—or lack thereof—was a further contributing factor as it concentrated and magnified the losses that eventually resulted.

Had the problems that led to the crisis been solved five years on? Banks were better capitalized and their risk-based ratios had certainly improved. However, the tremendous complexities of the risk-based model approach made it "almost impossible" to calculate capital ratios and an appropriate figure. "It's difficult for regulators to assess what's risky and what isn't," she suggested.

Repeating mistakes

Worryingly, Bair detects signs that the seeds of a further boom to bust are being sown. Regulators are again succumbing to pressure and making borrowing easier without the necessary safeguards and investors are desperate for yield, thanks to the prolonged period of low interest rates. The approach to derivatives was faulty, with insufficient regulation of the clearing houses.

Confucius also had an apt saying for current policy, she suggested: "If a man takes no thought about what is distant, he will find sorrow close at hand." Bair believes that an accommodative monetary policy that was timely and appropriate in 2008-09 has now been maintained for far too long and penalizes savers while rewarding borrowers.

"Both our bond market and stock market are inflated—indeed the stock market goes up when the news is bad as it means the tapering off of quantitative easing [QE] will be put back further. The result is that income inequality in the U.S. has worsened since the crisis, as it's the rich who benefit from the inflated value of stocks and bonds."

> "Corporate investment is also put on hold as it's difficult to tell how genuinely healthy the economy is and how much is owed to QE."

It also results in a quest for yield, as evidenced by pension funds abandoning traditional investments and moving into alternative, riskier classes. "Corporate investment is also put on hold as it's difficult to tell how genuinely healthy the economy is and how much is owed to QE."

Bair ended by saying that her political sympathies remained Republican, but nonetheless: "Congress get your act together and let's have a proper fiscal policy that includes fundamental tax reforms.

"We still have a dysfunctional political system. Washington needs to hear not only from the financial sector, but also the non-financial sector—and the users of credit as well as the providers." Regulators should also ease back on their efforts to micromanage financial institutions, which in future means allowing any of them unable to manage their risk to fail rather than being bailed out again, Bair added. ▲

This article originally appeared on gtnews.

Match Game

AFP Advisors Network pairs members for consulting projects

Ira Apfel

Some AFP members want to teach. Other members want to learn.

What's the best way to bring them together? The answer may be the AFP Advisors Network, the newest member benefit from the Association for Financial Professionals.

The AFP Advisors Network recruits and hires AFP members and then matches them with organizations in need of their treasury and finance expertise. The Advisors can work as a short-term sounding board or on a long-term project—whatever the organization needs.

"Our Advisors come from many backgrounds," said William Coyner, AFP Advisors Network Client Director. "Some may want to give back to their fellow members. Others have full-time jobs but are looking to expand the breadth of their skills. And others may be between full-time positions and are interested in possibly pursuing a consultative career."

Approximately 125 members have joined the Advisors Network, Coyner said. So far, the Advisors are located across the United States as well as Canada, Europe and South America.

Screening advisors

Coyner and Lauri Putt Needleman, AFP Advisors Network Manager, Advisor Relations, make sure every member that wants to join the network is properly screened and vetted for clients. With a combined 25 years in hiring and staffing for finance and financial services positions, they also learn the members' areas of strengths so they can find appropriate project matches.

"Our screening process consists of interviews and reference checks," Coyner said. "Some Advisors also provide video resumes so our clients can learn more about them."

As an added benefit to those who join the Advisors Network, AFP has engaged a third party to handle back-office issues, including billing and collections. "This is great for members because consultants typically get paid every 30 to 45 days whereas the Advisors Network pays every two weeks," Coyner said.

Putt Needleman added, "Advisors even get access to the third party's group insurance plans, so they won't have to buy insurance on their own—that's another challenge consultants typically face."

Other potential Advisors Network benefits include:

- **W-2 instead of multiple 1099s**. That makes advisors more attractive to lenders when applying for loans or mortgages.
- **Appropriate tax withholdings and expense tracking** so advisors won't have to itemize at the end of the year.
- **Contract negotiation support** on terms and conditions, statement of works or other business documents.
- **Pre- and post-tax retirement savings plan options**.
- **Brokerage link-account and access to financial advisor** at no additional fee.
- **Life insurance and long-term disability coverage**.
- **Personal business manager** to assist with contracting, benefits, billing, tax issues and more.

Once members join the Advisors Network, Coyner and Putt Needleman discuss projects with clients to ascertain their needs. The appropriate member is then paired with the client for the project. ▲

To join the AFP Advisors Network or to hire a member from the AFP Advisors Network, visit www.AFPadvisors.org.

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New Regs Improve RMB Offerings as Uncertainties Mount

John Hintze

In China's quest to transform its currency into an international power, AFP members are taking part.

Rogers Corp. was one of several multinationals operating in China asked to participate in pilot programs sponsored by the regional Suzhou government that stemmed from new regulations issued in late 2012 aimed at internationalizing the renminbi (RMB). A component allowing subsidiaries in China to lend RMB to their parents and affiliates outside the country opened to a broader range of corporations July 10 and it could ease longstanding restrictions that have trapped capital in the country and better equip corporates to deal with China's unfolding economic and financial risks.

"It certainly increases flexibility," said Easton Dickson, CTP, senior manager in Rogers Corp.'s treasury department and a member of AFP's Risk newsletter editorial advisory board. "You can now deploy funds in a wider variety of ways, with fewer administrative burdens."

The new regulations allow subsidiaries to lend RMB to their parent companies outside of China and vice versa, and they follow earlier steps the Chinese government has taken to promote the RMB has an international currency. Those steps include the creation of the offshore form of the RMB called the CNH, new offshore market centers for the currency as far away as London, and allowing banks much greater flexibility in the interest rates they can charge.

Jason Ekberg, principal of capital markets and investment banking at Oliver Wyman Group, noted the timeliness of the RMB lending rule's long-awaited arrival.

"When the RMB was strengthening, corporates didn't mind keeping their earnings onshore, but now that the currency is weakening and there's fear it will weaken further, they want to move their money offshore," Ekberg said. He added that multinationals running global treasuries often mandate limits on FX volatility, prompting them to move excess RMB offshore and swap it into other currencies to hedge that risk.

Given China's economic and financial uncertainties, the added flexibility provided to multinationals by the new RMB-loan rule comes at an opportune time. Highly profitable operations in China could lend surplus RMB to their parents via inter-company loans to repay debt, fund working capital, invest in new projects, or buy back shares.

Since the loans have to be swapped from RMB to USD or Euros, the ability to make RMB loans requires sufficiently liquid offshore swap markets in the currency to make swapping into other currencies feasible.

Dickson at Rogers Corp. said the additional means of funding the new rule puts a new tool in a treasurer's toolbox and could be especially helpful to companies sitting on sizable RMB balances, but "it's not a slam dunk." Eurozone cash is still attractive for inter-company loans because the rules are well-established, he said, and kinks in the Chinese rule must still be worked out.

Two "glaring negatives," Dickson said, are that only RMB balances count toward loanable funds, and that inter-company RMB loans to U.S. parents will eventually

Continued on page 5

***New Regs Improve RMB Offerings as Uncertainties Mount** continued*

be taxed as deemed dividends if they're outstanding too long. Rogers Corp., a manufacturer of high-performance foams, circuit materials, and other specialized materials, generates about 50 percent of its revenues out of Asia, primarily from China.

China has slowly stepped into permitting direct lending between a company's different legal entities, and in 2012 it began a pilot allowing companies to lend RMB to company cash pooling centers outside the country that offset deficits and surpluses in different geographies and currencies. In July, the PBOC issued a draft rule based on what it learned from the pilot program that's intended to facilitate cash pooling.

"So now you can do cash pooling, including bringing RMB offshore to cash pooling centers—a form of a loan," Ekberg said.

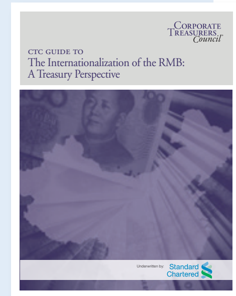
Dickson pointed to another component of pilot initiative that gives companies the ability to centralize the accounts payable and accounts receivable functions in a treasury pool that includes RMB, potentially making regional treasury operations more efficient. "If you have business in Japan or Korea, or other countries in the region, China could be a hub where you collect and make payments in and out of and also invest your cash," he said.

Dickson said questions remain about the treatment of withholding taxes if, for example, cash is swept into the China hub and earnings income before returning to Korea; in addition, certain jurisdictions such as Taiwan may be excluded from such a structure. He said Rogers has yet to participate in any of the pilots, preferring to assess them further to determine which components will yield the best value for Rogers. ▲

Read a longer version of this article here.

New

CTC Guide Helps MNCs with RMB Internationalization



The recent changes in RMB rules, and the broader picture of how to manage liquidity and funding in China, are covered in a CTC Guide on how companies manage their Chinese treasury operations. The guide delves deeper into the issues beyond the rules and includes case studies from companies with a long presence in the country such as Cabot, Ford, OSI and VMWare.

"Effectively, corporate treasurers can now bring China into the treasury management fold," said Michael Vrontamitis, Head of Product Management, Asia Transaction Banking at Standard Chartered Bank. "You can start taking a consolidated view of the renminbi exposure and manage the risk around it while executing payments and collections on a more centralized basis," The People's Bank of China has effectively enabled companies building up business in the real economy to not have capital account restrictions.

As investors look at companies with strong Chinese presence they will be questioning issues such as whether the RMB should be hedged, and how liquidity is being managed. "The real challenge for treasurers is to add value to the CFO and CEO conversation," said Vrontamitis. "It's not about the rules as much as about the strategic direction of the organization."

AFP Webinar

The Internationalization of the Renminbi: Treasury Implications

November 19 • 3 PM – 4 PM ET

Speakers:

Nilly Essaides, Director, Practitioner Content Development, AFP

Caroline Owen, Regional Head for RMB Solutions for the Americas, Standard Chartered Bank

Robert Vettoretti, Principal, PwC

Tina Kobetsky, Treasurer, VMware, Inc.

In July, the Chinese government announced two important changes that will enable US treasurers to better manage cash and FX in China: the simplification of cross-border trade settlement documentation and the launch of a new sweep program for companies with surplus cash in China. This webinar, based on a CTC Guide, will explain the recent changes within the broader context of the internationalization of the renminbi and includes case study presentations from treasurers with operations in China.

Learning objectives include:

- Understanding the recent developments in China that have allowed for better cash management and FX
- Understanding of how this can benefit your firm's operations.

Register here

Rupee's Fall Spares MNCs but Volatility Raises Concerns

John Hintze

The Indian rupee's dramatic decline in value since May has some multinational corporations basking in profits and others licking minor wounds. Whether helped or hurt, treasury and finance executives are wondering whether their firms should hedge against continuing swings, with further depreciation appearing most likely before next year's general election.

At just under 54 rupees per U.S. dollar (USD) at the end of April, the Indian currency plunged to more than 67 at the end of August—a nearly 25 percent move—and it has remained at about 65 ever since. Its steepest decline took place in August, when a volatility and value-at-risk analysis by Credit Suisse calculated the move's standard deviation at greater than three.

"On a statistical basis, August was a one-in-40-year event," said Anthony Capozzoli, head of corporate client analytics at Credit Suisse.

The collapse of the rupee coincides with the U.S. Federal Reserve Board's indications last May that it would soon begin tapering its quantitative easing (QE) program, in which it has bought \$85 billion in government bonds and mortgage-backed securities each month. The yield on the 10-year treasury, below 1.7 percent in early May, quickly rose and remains just shy of 3 percent.

The Fed's QE program prompted investors to seek higher yields in emerging markets given their expectation for prolonged low U.S. rates. Now, those investments have been liquidated and EM currencies are taking a beating, said Trey Garza, vice president in corporate FX sales at Credit Suisse.

Adversely affected

For multinationals with production facilities in India that sell to the Indian market, in sectors such as pharmaceuticals and perhaps consumer goods, their revenues and profits in rupees have sunk. Jeff Wallace, managing partner at Greenwich Treasury Advisors, noted that risk couldn't have been hedged because U.S. accounting standards only permit hedge accounting, which corporates need to avoid earnings volatility, when transactions involve different currencies. Given the fledgling Indian market, however, shrinking rupee revenue is unlikely a major concern for most corporates.

"Will a decline in rupee profits really impact U.S. multinationals selling locally? Probably not," Wallace said, given their mostly long-term perspectives should outlast current rupee volatility.

The bigger impact is on multinationals producing Indian goods and services for export that are paid in dollars. "They're basically short rupees and long dollars, and that's a pretty good situation to be in," Wallace said, since their local production costs have just been slashed relative to the dollars they are paid.

Spokesmen for Xerox Corp. and Automatic Data Processing, which have established significant outsourcing businesses in India that service corporations in the U.S. and elsewhere, declined to comment on the impact of the depreciating rupee.

"The absolute rate is not so much a concern for the industry as the volatility. Such sudden fluctuations impact the planning process for companies and customers."

"The absolute rate is not so much a concern for the industry as the volatility. Such sudden fluctuations impact the planning process for companies and customers," said Som Mittal, president of India's National Association of Software and Services Companies (NASSCOM). "We hope to see the rupee stabilizing for better planning and decision making."

Garza said most of the corporations he's spoken to have assets, such as physical invoices and inter-company loans, which must be converted to dollars or revalued on their books on a monthly or quarterly basis. The equivalent of a \$100 million inter-company loan made to an Indian subsidiary in rupees early this year, for example, is worth significantly less now, dropping 10 percent in August alone.

The questions those companies face are when will the rupee start to appreciate in value, and will it sink further before then. Garza said companies are typically hedging further depreciation risk by effectively selling rupees and buying USD at a pre-established rate using non-deliverable forwards (NDFs). Some are beginning to use the onshore deliverable FX swaps that Wall Street has been promoting, because they are simpler and more exact hedges. However, they require a relationship with a major onshore bank that's willing to take on the onshore subsidiary's credit risk.

Companies are also legging into their hedges; for example, buying 20 percent portions of the overall hedge they're seeking by year-end on an opportunistic basis when the rupee's value dips over the next several months. ▲