2018

FTA
FINANCE & TREASURY ASSOCIATION

EXCHANGE magazine

Managing liquidity through periods of evolving monetary and regulatory enviroment

Streamlining the TMS selection process

Australian companies are embracing corporate bonds

Table of contents

Message From the CEO

Ben Leaver - CEO
Finance and Treasury Association

Dear Members and the FTA Community

It is with pleasure that I write this, after my first year in the role as CEO, updating you on the progress that we have made over the past twelve months, as well as a snapshot into where we are headed.

A year ago at the FTA AGM, President Mike Christensen spoke of the strategic priorities that the Board were focused on.
These were -

- Complete the content and product strategy linked to value propositions and start delivery
- Build out our strategic partnerships
- Review the FTA product offering, packaging and pricing; for example, should we be offering corporate membership?
- Continue to invest in our technology stack

These priorities remain at the forefront of our work, and are captured within our three stage strategy, which I have categorised as Traditional/Progressive/Radical.
Our traditional strategy work revolves around getting the basics right – delivering what our members require as minimum expectations. That means customer service, ease of renewals, a strong CPD program, and access to quality content via our website and distribution channels.

The first component of this was to review and then implement our revised staffing structure. As a result, Naomi Braham has returned to the FTA and has done an outstanding job in shoring up our renewals process, cleaning up and updating our database and ensuring our financial operations are efficient. As I said, Naomi has done a great job – with her help, along with other initiatives and work from the Board and Committees, membership has turned the corner – from April to June it grew by 8%, and from April to September by 14%.

Secondly, we have recently bought into the FTA Sandra Perrett. Sandra has commenced a new role as Marketing and Communications Manager after a successful career within the Association, Banking and Education areas. In the early days of her role Sandra is reviewing our strategy around content delivery – we need to become much more proactive in how we source and deliver a larger amount of relevant information to our members. She is also overseeing the revamp to our online library, working on our overall marketing and digital strategy and working closely with the Technical and State Committee's on our CPD program. Our State Committees are working hard to bring quality functions to their respective State's. Hopefully you have noticed that we have revamped our quarterly State functions this year, with guest speakers providing a more informative feel without being a technical session – attendance and feedback to date has been terrific.

We can still do with some more help within these committee's though, so any interest would be greatly welcomed. Sandra's expertise will also help us better understand the needs of members going forward, which will help us define what membership looks like into the future – including what category of members we should have, and who our market is.
Our Progressive strategy is to introduce or improve a more diverse range of products and services. This includes a re-launch of our Mentor Program, which sees us this year with 16 participants. As part of this program we plan to remain engaged with our mentee's, inviting them to become part of an Advisory group, letting us know how best to look after the needs of the up and coming Treasury leaders.
We have also worked hard on rebuilding our relationship with the Women in Treasury group, and have held a number of successful events, including our International Womens Day breakfast in Melbourne attended by 160.

Last year Mike commented on the need to work closely with partners. We are not a highly resourced organisation (yet!) and as such a large part of our future growth must include partnerships – this includes partnering on delivering education programs such as Treasury Management and Fundamentals via KPMG and Deloitte, but also some newer offerings that are more targeted such as FX Risk and Leasing standards.

We are also providing content to the SME market around education and awareness of treasury strategy with partners Rochford and Barrington, and will look to build on this work to further educate this segment. In addition, we have worked very closely with Ernst and Young and CBA on our Essential Treasurer series and are currently reviewing how that program looks going forward. And of course our Conference would not be the success it is without the enormous contribution of our partners – there are too many to mention here, but I thank them so much for their support.

I'm also pleased to advise that we are in talks with a small number of companies around a corporate membership offering – this will be a soft launch but we hope to advise of the first partners in this program shortly.

Finally, we are beginning discussions and research on the more radical possibilities for the FTA – which revolve around a true certification product. By certification product, I refer to an educational program similar to those offered by the ACT, CPA or AICD, that gives us an industry recognised standard. With this in place, we begin to professionalise the Finance and Treasury workforce and we can rebuild our business model around this via the Value Proposition, the way we communicate and the way we provide and develop CPD. At the moment we are exploring options on how and what this looks like – do we partner, do we develop our own, do we do a little of both. No doubt this could be a very exciting time for the FTA and our community.

In 2018/19 our approach is to be great at Traditional, commence and be good at Progressive, and to plan for the Radical. We will do all this by being modern – using technology to deliver to and understand our members better ; by being relevant, making better use of our extensive network to source, curate and deliver relevant information and learning; and by being community oriented - our community is wide and covers members, potential members, stakeholders and partners.
We strive to be open and transparent, listening and responding to the feedback of our members. We will be consistent in our desire to connect, engage and develop!

Thanks

Ben

When The Cycle Turns:

REITs Around The World Are Braced For Rising Rates, Tighter Funding Conditions

While the risk of rising borrowing costs and tighter funding conditions grows across a number of major property markets--and for the real estate investment trusts (REITs) whose income depends on these markets--the REITS rated by S&P Global Ratings are generally well-positioned to withstand a gradual rise in interest rates as their capital structures are largely fixed or hedged.

In the U.S.--the world's biggest market for REITs, at roughly the size of Europe and Asia combined--these entities have shored up their balance sheets against the backdrop of a Federal Reserve that is steadily raising interest rates as it normalizes monetary policy, and yields on benchmark Treasuries look set to rise accordingly. S&P Global Ratings economists forecast one final quarter-point rate increase from Fed policy makers this year (for a total of four) and three in 2019, which would bring the benchmark federal funds rate to 3.0%-3.125%, up from effectively zero in the aftermath of the Great Recession. We expect the 10-year yield to reach 3.2% by year-end, 3.4% at the end of next year, and 3.5% in 2020. While these increases could weaken REITs' EBITDA interest coverage and fixed-charge coverage ratios, the fact that our rated REIT universe consists largely of fixed-rate debt mitigates this risk. As it stands, fewer than 20% of U.S. REITs we rate have debt structures with more than 25% exposure to variable-rate debt.

Moreover, debt maturities appear manageable, in our view, with just 3% of outstanding debt coming due before year-end, followed by 7% and 11% in 2019 and 2020, respectively. Furthermore, cash flows are rising and debt levels are falling. As a result, the total debt-to-EBITDA ratio in the sector has improved to the lowest levels since the financial crisis, declining to less than 6x last year, from a peak of almost 8x in 2010.

Similarly, rising interest rates and tighter funding conditions pose key risks across the Asia-Pacific real estate markets. Indeed, borrowing

Craig Parker
Senior Director, Corporate Ratings,
S&P Global Ratings

costs and spreads are increasing, and investor sentiment points to a potential turn in the U.S. credit cycle late next year that would likely have repercussions around the world. Still, most Asia-Pacific REITs we rate can absorb a gradual increase in rates, given their robust interest coverage metrics, limited amount of floating-rate debt, and modest upcoming maturities. But a sudden and sharp rise could affect the credit quality of the region's REITs.

When we looked at how three levels of interest rate increases--100 basis points (bps), 200 bps, and 300 bps--would affect REITs' various credit measures, we found that rated Asia-Pacific REITs are well-positioned to cope because they have fixed a greater portion of their debt book amid low interest rates, and their liquidity positions are either strong or adequate. Under the more severe stress scenarios, a small number of entities that have significant exposure to floating rates would face ratings pressures.

At any rate, Asia-Pacific REITs have reduced overall debt levels and kept debt-to-EBITDA leverage (excluding Japan) under 5.0x in recent years, from a peak of 5.6x in 2008. In particular, the Australian and New Zealand REITs largely sit at the lower end of their targeted gearing ranges (debt to assets), providing a buffer in their balance sheets (see chart).

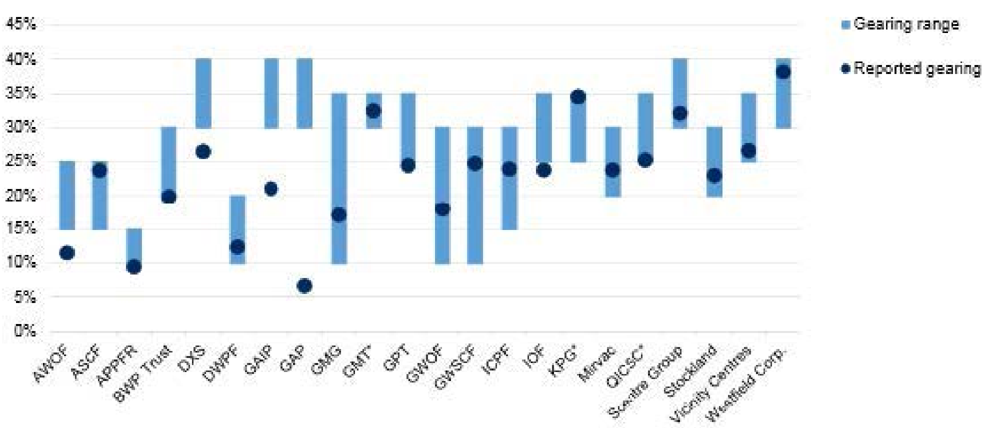
Likewise, most REITs in Europe have fixed or hedged their debt for the next 3-4 years, and the direct effects on funding costs and interest expense coverage ratios appears limited and unlikely to be the sole trigger of negative rating actions. A more significant side effect in Europe could be that limited increases in rates, if unaccompanied by higher inflation, would depress asset values.

To gauge how lower asset values could affect the asset-based credit metrics of European REITs we rate, we ran a second round of stress scenarios, incorporating arbitrary drops in portfolio value over the next two years. Across our sample, a 5% drop in portfolio value is unlikely to trigger rating actions; a 10% fall would likely cause at least a few outlook changes and a handful of downgrades; a 20% drop could trigger downgrades for several companies.

However, we believe there are several buffers protecting real estate asset values in Europe against rising interest rates. These include the widespread indexation of rents to inflation, a high risk premium between discount rates and risk-free rates, and generally prudent assumptions that independent appraisers use in their line-by-line valuation process.

All told, we expect global REITs we rate to be able to withstand a moderate pace of rate increases, with debt coverage ratios such as fixed charge coverage and EBITDA interest coverage weakening only modestly.

Gearing Versus Policy Ranges
Australian and New Zealand REITs' gearing as of Dec. 31, 2017



*Based on latest information availabe. AWOF--AMP Capital Wholesale Office Fund. ASCF--AMP Capital Shopping Centre Fund. APPFR--Australian Prime Property Fund Retail. DXS--Dexus. DWPF--Dexus Wholesale Property Fund. GAIP--Goodman Australia Industrial Partnership. GAP--Goodman Australia Partnership. GMG--Goodman Group. GMT--Goodman Property Trust. GPT--GPT Group. GWOF--GPT Wholesale Office Fund. GWSCF--GPT Wholesale Shopping Centre Fund. ICPF--Investa Commercial Property Fund. IOF--Investa Office Fund. KPG--Kiwi Property Group. QICSC--QIC Shopping Centre Fund.
Source: S&P Global Ratings.

Australian companies are embracing corporate bonds

Since 2010, the Australian corporate bond market has grown by more than 40 per cent, to over $1 trillion, making it more than two thirds the size of the ASX.

As at June 2017, total bonds on issue by Australian banks was $540 billion, with another $460 billion on issue by other financial institutions, and $255 billion by non-financial corporates.

The popularity of corporate bonds as a key part of a company's funding strategy is on the rise, becoming an increasingly viable alternative to traditional funding sources. This is particularly evident in today's environment where structural shifts are occurring in the funding market, with traditional bank lending tightening.

As a leading provider of non-bank debt finance in Australia, FIIG Securities recently partnered with Deloitte Access Economics to develop the 'Corporate Bond Report 2018: Australia's growing appetite for corporate bonds'. The inaugural report uncovers the latest trends in the corporate bond market, reveals what is driving issuer behaviour, highlights future opportunities, and above all else, demonstrates significant untapped potential.

John Ricciotti
Executive General Manager – Fixed Income,
FIIG Securities

Strong growth in issuer activity

Corporate bond funding in Australia has been rising steadily over the last 10 years, up from six per cent in 2007 to 11 per cent in 2017. While bank lending remains the largest source of funding for Australian corporates in aggregate, companies are increasingly accessing corporate bonds, buoyed by a number of key benefits. With corporate bonds, companies can negotiate a range of covenants that are tailored to the business, and bonds offer greater flexibility in features such as longer terms and debt financing that can replace or complement existing funding arrangements.

Corporate bonds also provide relative certainty in funding and covenants until their maturity date, enabling companies to fund long-term growth strategies.

Innovation driving opportunity
Whilst debt capital markets have historically been the domain of companies with a credit rating, in recent years, innovative funding solutions have seen the emergence of unrated bonds. The number of unrated issues increased from 16 in 2012-2014 to 39 in 2015-2017, with a value totalling more than $1.1 billion in 2017.

FIIG Securities has been at the forefront of this innovation since 2012 when it opened up the Australian bond market to corporates by developing a long-term unrated bond offering. The first unrated bond deal issued by FIIG was a $30 million issue for Silver Chef, which was subsequently refinanced in the bank market in September 2015. Over the past six years, FIIG has continued to lead the market, issuing more than 50 corporate bonds totalling over $2 billion in funding. Bonds have been issued for a range of unrated companies in different industries including listed childcare provider G8 Education, remote power generation company Zenith Energy and leading consumer law firm Maurice Blackburn.

Strong investor support
More than 4,000 investors have participated in corporate bond issues arranged by FIIG, demonstrating strong and growing demand for corporate bonds.

Despite growing demand, private bond ownership in Australia still trails other OECD nations, signalling an opportunity for further growth as the market matures. Deloitte Access Economics found that 16 per cent of Australian High Net Worth individuals (HNWIs) are invested in direct corporate bonds. Further, private investors in Australia hold less than one per cent of all corporate bonds on issue in Australia compared to almost 20 per cent in the United States. Despite this lag, Australian investor appetite for corporate bonds is gaining momentum, with 15 per cent of non-investors planning on investing for the first time in the next year, and the share of Australian HNWs with corporate bond investments expected to almost double in the next 12 months, from 16 per cent to 29 per cent.

A similar story is apparent among Australian institutional investors, including superannuation funds, large corporates, not-for-profits and universities, which hold only 10 per cent of their assets in bonds and bills, compared to 40 per cent held by superannuation funds across other OECD countries.

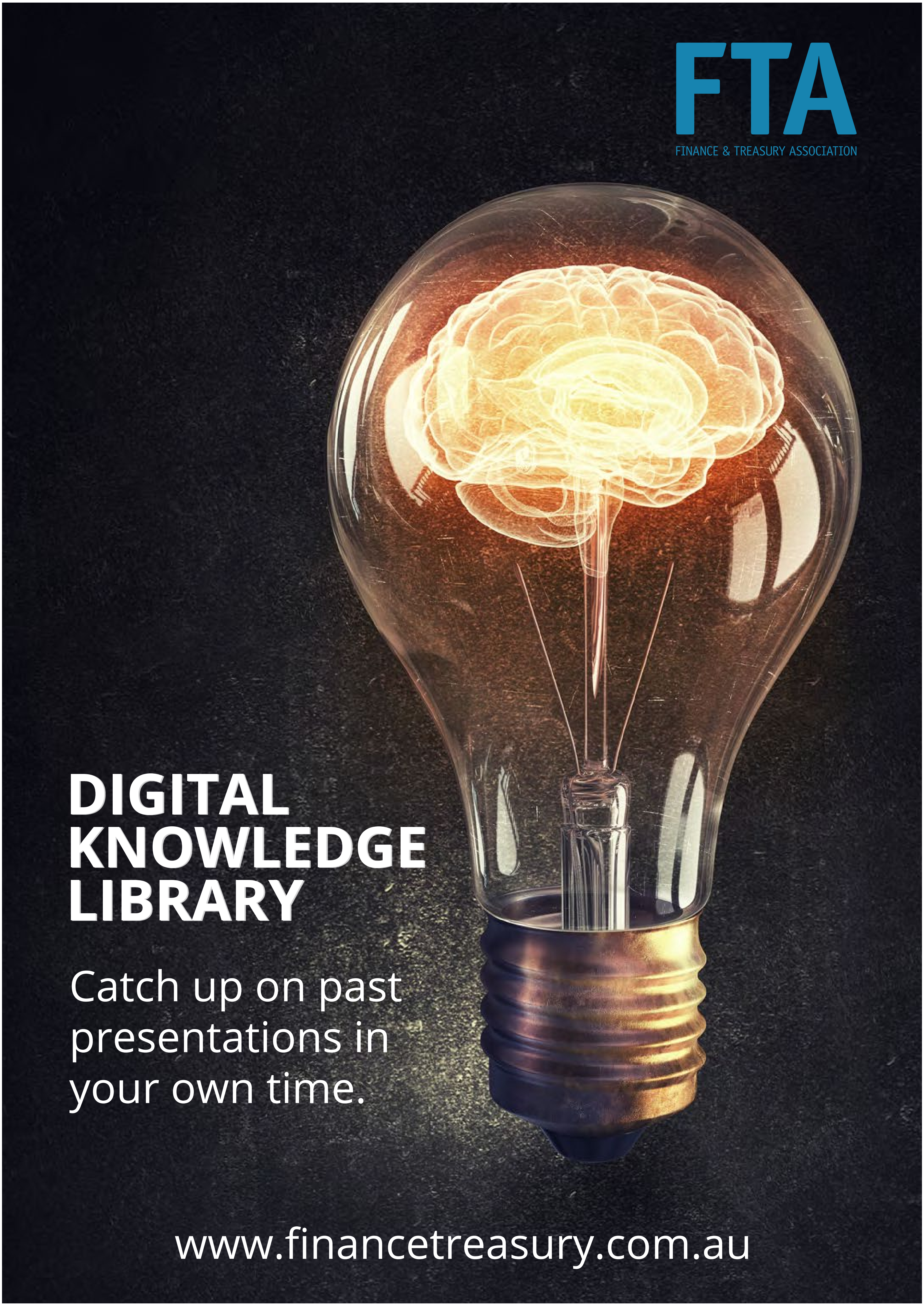
For both corporate and institutional investors, capital preservation is a key benefit alongside achieving better yield. Non-financial companies and not-for-profits, for example, often maintain investment portfolios, as they can be required to hold capital reserves for risk management or to fund future operations. Of particular importance to institutional investors such as superannuation funds or insurers, corporate bonds can also deliver a reliable income stream, providing a typical yield in recent years of one to four percentage points higher than yields on Australian Government bonds.

The outlook for corporate funding
The benefits brought by corporate bonds are increasingly evident as the lending landscape shifts. Funding diversification ultimately means companies can strengthen balance sheets and reduce dependency on any individual source of capital such as bank lending.

In line with growing investor appetite for corporate bonds, Australian corporates are also increasingly recognising the benefits of bonds and demonstrating strong demand for this alternative funding solution.

The funding landscape is evolving and corporate bonds are arguably at the forefront.

To find out more about the Australian corporate bond market download a copy of the Deloitte Access Economics Corporate Bond Report 2018: Australia's growing appetite for corporate bonds at fiig.com.au and visit https://fiig.com.au/debt-issuers/debt-capital-markets to learn more about FIIG's debt offering.


FTA
FINANCE & TREASURY ASSOCIATION
DIGITAL KNOWLEDGE LIBRARY
Catch up on past presentations in your own time.
www.financetreasury.com.au

Managing liquidity through periods of evolving monetary and regulatory environment

Aidan Shevlin, CFA
Head of Asia Pacific Liquidity Fund Management
J.P. Morgan Asset Management

The normally activist Reserve Bank of Australia (RBA) has left rates unchanged at a record low of 1.5% for a record period of time.

Caught between the challenge of low inflation and an elevated housing market, the overnight cash rate is likely to remain unchanged for the foreseeable future, limiting opportunities for higher investment yields.

This also implies that the current record wide interest rate spread differential[1] between the Federal Reserve Bank (Fed) and the RBA could widen even further to as high as by the second quarter of 2019 if the Fed continues its current rate hike trajectory – with potentially negative consequences for the Australian dollar and the yield curve.

Meanwhile, the steady encroachment of Basel III rules has curtailed the ability of banks to offer attractive time deposit rates on cash deemed "non-operational", reducing the yield pick-up investors previously enjoyed – especially for shorter tenor deposits. Finally, the recent queries by the Royal Commission regarding the liquidity of different instruments, securities and maturities have prompted regulators to reconsider long held beliefs about the very definition of cash.

These challenges represent a significant reversal for Australian corporate treasurers more familiar with high returns on cash, a wide range of local banks bidding aggressively for their deposit business and the availability of a broad range of higher yielding securities for additional yield pick-up, if necessary. Tighter credit bank limits and a decline in credit rating quality will likely magnify these issues.

Nevertheless, several techniques and products developed and refined during the past decade of zero US interest rates should help Australian corporate treasuries mitigate some of these challenges while optimising their cash management. These techniques include clarifying investment policies, creating well-defined investment objectives, implementing cash segmentation and ensuring good investment diversification. Meanwhile, products include money market funds, ultra-short duration bond funds and separately manager portfolios.

An organization's investment policy statement forms a solid foundation for cash investment decisions. It helps define short-term investment objectives and the strategies for achieving them. It also outlines acceptable levels of risk, return requirements, permissible investments and other relevant constraints. A well-written

[1] The interest rate differential is currently 75bps

policy provides clarity, instills discipline and helps ensure good governance; updating this document on a regular basis also allows an organization to successfully navigate shifting markets, changing regulations and evolving business needs.

The organization's investment objectives are derived from the investment policy and typically balance a combination of preserving capital, while maintaining suitable levels of liquidity and maximizing returns. Capital preservation – protection of principal – is generally the primary objective of many organizations. Ensuring adequate liquidity is also critical, especially during times of financial stress where the inability to access cash can trigger major challenges. Finally, maximizing returns or generating income – potentially versus a benchmark is also an important goal in general – but this should be balanced against the likely increase in volatility of principal.

Low and moribund market yields exacerbate the opportunity costs associated with very high levels of liquidity and principal protection – and may encourage an unintentional increase in risk to boost returns. A more disciplined approach of cash segmentation and investment diversification can achieve the same higher returns without excessively increasing risk or volatility.

A critical first step for cash segmentation is creating an accurate and detailed cash forecast – determining what percentage of cash needs to be immediately accessible and what percentage does not. Once completed, the organization can segment its cash among operating cash (for same day liquidity), reserve cash (with an investment horizon of six to twelve months) and strategic cash (with an investment horizon greater than one year), each with different liquidity, investment and risk profiles. Meanwhile, diversifying across a broader range of instruments, issuers and regions can help reduce concentration, expand sources of return while lowering risk correlation.

Combined these steps can help investors achieve more optimal investment results of additional return within acceptable levels of volatility.


ION TREASURY
Our products, your journey
Wherever you are on your digital journey, we have a solution for you.
CITY FINANCIALS
IT2
ITS
OPENLINK
REVAL
TREASURA
WALLSTREET SUITE
treasury.iongroup.com
treasury-info@iongroup.com

Economic headwinds trigger a re-think in capital management processes

Marcus Blake
Director – Distribution,
Investment Management
FIIG Securities

Organisations across Australia have faced a prolonged period of historically low volatility and low interest rates coupled with an increasingly strict regulatory environment, forcing many to review cash investment strategies.

At a time when market uncertainty is driving companies to increasingly allocate portfolios to cash, there is a need for active management of a cash investment strategy.

The regulatory landscape is in a state of flux at a national and international level, as Basel III, the Banking Royal Commission, and Anti-Money Laundering enhancements are initiating a tightening of compliance surrounding cash management.

With a stream of new investment and funding sources, including the likes of ETF's and Peer-to-Peer lending also disrupting the market, and a low interest rate environment, the search for yield continues to be complex.

When looking at the Authorised Deposit Taking Institution (ADI) landscape, rates can vary market-wide by up to 20bps for short term and as much as 50bps for longer term deposits over a single day – which means there could be forgone investment opportunities.

As the investment landscape continues to evolve there are several key elements that are paramount for treasury departments around the country to consider as part of their cash management strategy execution:

- Governance and control – including maintaining an appropriate department structure, managing resources efficiently and monitoring and reporting investment compliance with policies and controls in place
- Risk mitigation – identification, assessment and addressing of risks inherent in the financial system
- Cash and liquidity management – safeguarding day-to-day, short-term cash controls, trade finance and payables, while also ensuring adequate liquidity

It takes time and resources for treasury teams to continuously track term deposits and market performance in line with the above key metrics; a pain point that FIIG resolves with its Money Market Optimiser Service.

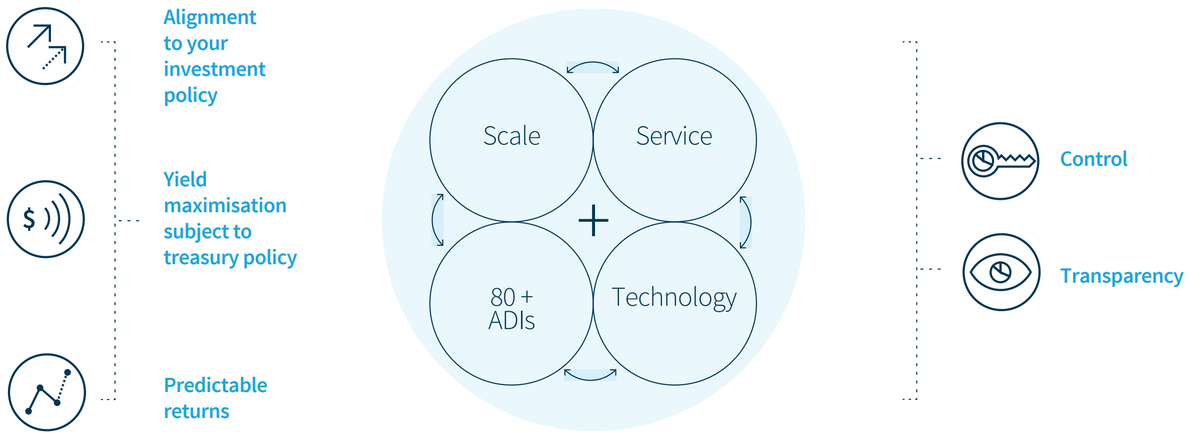
For treasury teams, engaging a reputable third-party to implement a money market strategy can significantly reduce the facilitation and management burden - driving operational efficiencies, cost savings and delivering improved investment returns.

The FIIG Money Market Optimiser is a liquidity management solution that makes the most of an organisation's cash by matching their investment criteria to deposit opportunities across an extensive panel of 80 domestic and international ADIs.

The service allows managers to tailor a portfolio within specified guidelines. Dedicated relationship managers leverage FIIG's scale and long standing ADI relationships combining research insights, ADI funding requirements and price discovery to manage deposits.

Although fintech providers in this space offer a cloud based alternative that executes for part of the process, they do not provide capacity to engage in negotiation and manage the unique and sometimes complex needs of stakeholders.

Optimiser can be utilised as an Individually Managed Portfolio with discretionary authority for day-to-day portfolio investment in accordance with a client's specified investment criteria, or clients can opt to engage more closely and authorise individual decisions. No matter which level of service a client selects, they retain line of sight over every aspect of their cash portfolio.



Optimiser

Optimiser is a service that combines a technology interface with strategic negotiation and stakeholder relationship management.

All organisations need to hold cash in their portfolio and Optimiser is about building a strategic solution to make this cash work harder. The service ensures organisations cash portfolios are optimised at all stages of the interest rate cycle. It also facilitates risk management, pre-trade compliance and performance reporting, freeing finance team resources.

About FIIG

As Australia's largest independent fixed income specialist, FIIG's well-established money market expertise combined with the capability of over $5.0 billion of cash under management provides FIIG with a significant advantage when dealing with ADIs.

For 20 years, FIIG has helped superannuation funds, not for profits, small and large companies, as well as individual investors, trusts and SMSFs, secure better returns from fixed income investments.

The FIIG team seeks to work in partnership with treasury teams, and their advisors, to provide better and broader access to conservative, yet materially higher yielding Cash and Fixed Income investment solutions.

With over 140 staff in its Sydney, Melbourne, Perth and Brisbane offices and an international office in Malta, FIIG has pioneered many market developments, using its leading research, investment tools, sector knowledge and relationships to provide custom solutions to complex investment challenges.

Money Market Benchmark Reform in Australia

Nick Burrough
Fixed Income Specialist,
Bloomberg L.P

Introduction

Australia's efforts to reform money-market benchmarks are considered to be ahead of the curve by the country's global peers. These changes address issues that date back to the 2008 financial crisis, when the extreme volatility of markets from mid-2007 on created an environment where banks could readily falsify LIBOR submissions.

While it would be incorrect to say there were no falsified submissions prior to GFC – indeed, in a July 27, 2012 article in the Financial Times, one former trader claimed to have witnessed LIBOR manipulation dating back to 1991 – the level of falsification was much less substantial.

During the GFC, however, LIBOR submissions varied so widely from levels believed to be fair that the integrity of the benchmark itself was called into question. In July 2012, the UK's Serious Fraud Office opened criminal investigations into the manipulation of interest rates, since when over 20 banks have been named in their investigations.

<u>**Volatility of cash rates rose dramatically during GFC**</u>

Following these allegations it was clear that reform of benchmark reference rates was required and

in July 2013, the International Organization of Securities Commissions (IOSCO) issued its "Principles for Financial Benchmarks" following a short consultation period, stating:
"The data used to construct a Benchmark should be based on prices, rates, indices or values that have been formed by the competitive forces of supply and demand (i.e., in an active market) and be anchored by observable transactions entered into at arm's length between buyers and sellers in the market for the Interest the Benchmark measures"

Clearly, LIBOR and some other similar benchmarks aren't based on "observable transactions" and so the death of LIBOR became inevitable, and is due to take place in 2021. Even prior to the publication of IOSCO's principles a number of LIBOR rates were retired, including all AUD LIBORs in May 2013, and even some illiquid BBSW tenors, including 9 Month & 12 Month BBSW, in January 2009.
The domestic AUD BBSW fixing is based on real trades of negotiable Bank Bills/NCD. This is fundamentally different to the submission for LIBOR, which involve subjective views of interbank lending. While BBSW has had its own share of challenges, subjectivity of bank submissions is not amongst them.

Changes to AUD BBSW methodology

Unlike LIBOR, it is intended that AUD BBSW will persist into the foreseeable future, a view supported by the RBA:

"In Australia, in contrast to other markets, the changes to enhance the longevity of BBSW are well advanced, and it has been possible to anchor the benchmark to a greater number of transactions... There is still a place for robust credit based benchmarks in the financial infrastructure, and we expect that BBSW and the cash rate will be able to coexist as the key benchmarks for the Australian dollar." - Guy Debelle, Deputy Governor of the Reserve Bank of Australia.

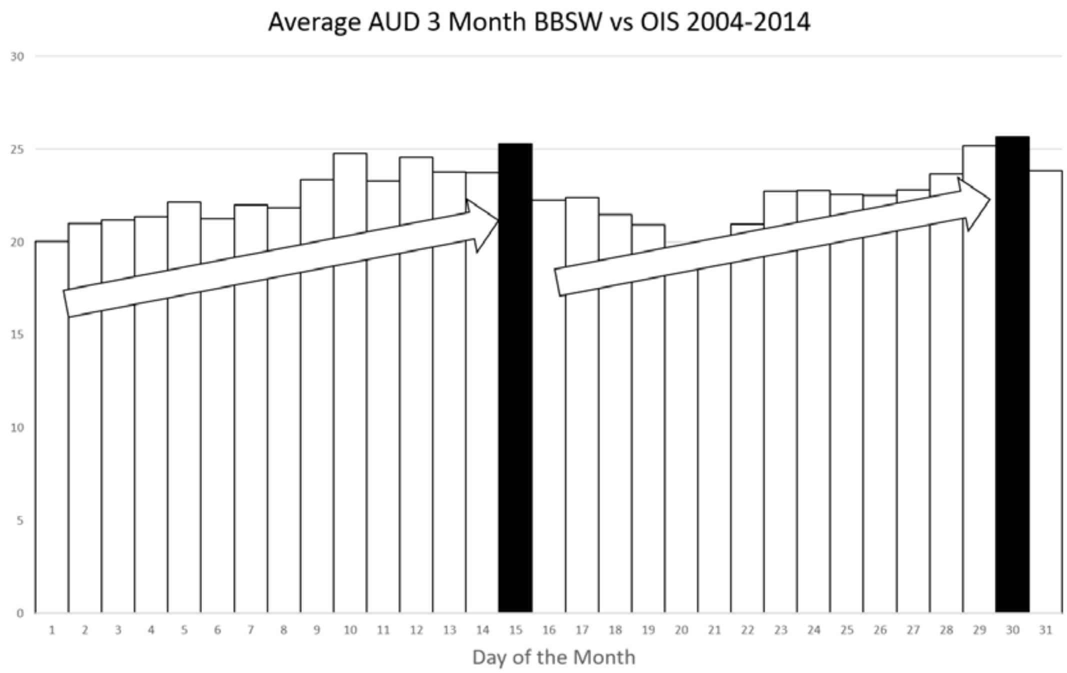
Despite the intended continuation of BBSW changes to the calculation methodology have been made. The two major methodology changes are:

- VWAP calculation over a rate set window (8:30am – 10am)
- Rolling Maturity Pools of +/-5 business days of straight run maturity (no "Early vs. Lates")

For the corporate treasurer these changes can only be a good thing. The methodology will certainly lead to a more robust calculation and, perhaps just as importantly, the bias for BBSW to set higher in the middle and at the end of the month (the Earlies/Lates effect) has been removed.
For derivatives execution, the debates over adjustments to swap curves for the dates on which derivative instruments reset were tiresome for both banks and corporates. However, some month-end pressures for higher rates are likely to persist, as they do in most currencies. The statistical analysis over a 10-year period shown below illustrates the 'seasonality' of BBSW across a calendar month.

The chart shows the average spread of BBSW to the OIS (risk free curve) for each day number of the month and demonstrates a clear trend upwards across both the first and second halves of each month. This seasonality is no longer present following the modified BBSW calculation method.

Despite the improved calculation methodology of BBSW, fallback provisions are required for the unlikely event that that BBSW cannot be calculated. ISDA determined that an alternative risk free rate should be used in fallback provisions and invited feedback during a consultation period ending October 2018.



The only viable alternate rate in AUD is the RBA Cash Rate. The use of this risk-free overnight rate as a fallback for a bank credit-based index (IBOR) of tenors up to six months is not ideal. Alternative methods for treatment of both the term structure of interest rates and credit premiums have been put forward by ISDA for feedback.
Further details are available within ISDA's paper "Consultation on Certain Aspects of Fallbacks for Derivatives Referencing GBP LIBOR, CHF LIBOR, JPY LIBOR, TIBOR, Euroyen TIBOR and BBSW" (https://www.isda.org/2018/07/12/interbank-offered-rate-ibor-fallbacks-for-2006-isda-definitions).

The future post-LIBOR

It is too early to breathe a sigh of relief, unless you only have exposures to AUD. For many corporates the transition from LIBOR will pose both legal and technological challenges. Currently it is proposed that USD LIBOR will transition to USD SOFR, which is based on Bond Repo transaction data. Challenges to consider include:

- Will a 3 Month etc. Tenor SOFR develop to replace a 3 Month LIBOR? If not, how will the existing Overnight SOFR be used?
- At what credit spread will transition from LIBOR to SOFR occur?
- Will loans and derivatives transition similarly?
- How will cross currency derivatives be priced and valued once AUD BBSW vs. USD LIBOR basis swaps cease to exist?

The volume of work for system vendors, data providers, IT departments, lawyers and corporate treasurers is large. The cost estimates for major banks have already reached levels that have escalated decision making to the board level.

Summary

The Australian market has made significant progress on benchmark reform. A money market based on negotiable instruments (BBSW) and not bilateral interbank loans (LIBOR) has helped the country meet IOSCO principles of transaction-based index calculation, and existing BBSW methods have been reviewed and enhanced. The changes in offshore markets are likely to prove more difficult, particularly USD, which is a major global pricing and trading currency and forms the base for many cross-currency transactions.

The phasing out of LIBOR by 2021 will come around quickly – and the volume of work is easy to underestimate. Bloomberg is working closely with regulators and associations to ensure our customers will be able to make the transition on time, with minimal disruption.

Access to liquidity providers at your fingertips.

With over 2,300 institutional clients and 180 leading FX banks and alternative market makers, **Thomson Reuters FXall** offers corporations, assets managers and hedge funds access to deep liquidity with choice in execution, end-to-end workflow management and straight-through processing - covering the entire transaction lifestyle.

Put simply
FXall gives you the competitive edge.

**TO LEARN MORE,
VISIT WWW.FX.COM**

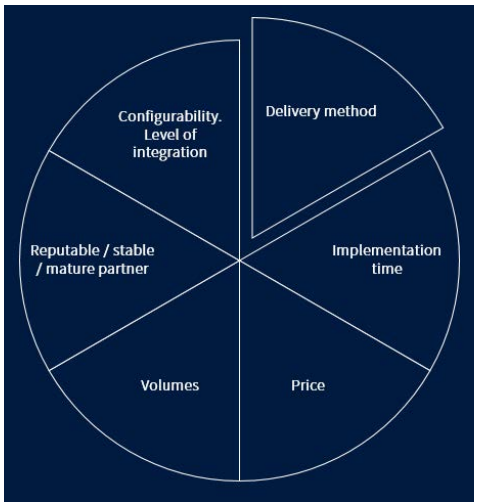
The Financial and Risk business of Thomson Reuters is now Refinitiv

the answer company™
THOMSON REUTERS®

Streamlining the TMS selection process

George Chapman
Head of Sales - APJ
ION Treasury

When selecting a Treasury Management System (TMS), many corporate treasuries lean heavily on Request for Proposal (RFP) documents. For some treasury organisations, these documents represent the beginning, middle, and end of their decision-making process.



Example: Top Selection Criteria for a TMS

The primary benefits of the RFP process are to determine what functionality you need from your TMS and to evaluate multiple vendors in a systematic fashion. However, the process isn't efficient and shouldn't be relied on as the most important measure of a system or vendor's worthiness.
We've seen the RFP process take an average of 3-4 months. If the most important business needs aren't being addressed in the RFP, your team may lose several months without getting any closer to a decision. And that loss of your team's time and energy may be further compounded if you contracted a third-party consultant to manage the RFP process.

What can treasury organisations do to streamline the selection process?

1. Customise and prioritise business needs

If you're going to issue an RFP, avoid using a 3rd party template and instead create your own customised form that truly reflects your business needs and expected outcomes. After all, no two corporates are alike. Generic RFPs don't give vendors the opportunity to differentiate their solutions, and most likely won't tell you whether their systems are likely to meet your most important requirements. The more detail you can provide about your needs and expectations, the more valuable a tool the RFP will be.

2. Define key business drivers and specific criteria

We strongly recommend that you clearly define your top five or so most important business criteria for selecting your system. Are you looking for SaaS or cloud delivery? Do you have limited budget? Are your trade, payment, or transaction volumes particularly high? Do you need to be up and running on a new solution very quickly? Is your business changing and growing at such a rapid pace that configurability, customisation or scale are must-haves?

Defining these make-or-break criteria up front can significantly narrow the playing field and help you rule out a system or vendor before the RFP process begins.

3. Ensure all key stakeholders are involved in the RFP process

Do you need to involve the finance, accounting, risk, trading, or procurement teams in this process? What are their functional needs for this application? How will their priorities be weighed, vs. the treasury team's needs? It's important for you to define these things up front to make the RFP process more efficient.

4. Select a dedicated project manager who will run both the RFP process and the implementation

A project manager who is focused exclusively on this project will best be able to ensure the various tasks are happening simultaneously so that you can be more efficient during the selection process. And by overseeing the complete selection process, that project manager will know how to prioritise the implementation project for the business based on what the vendor is expected to deliver.

5. Get familiar with the current vendor landscape

While working on the RFP, we suggest getting to know the vendor landscape better by meeting with them early on, learning what differentiates them from each other, and determining whether being in a long-term partnership with them is going to benefit your company.

6. Run through vendor presentations before issuing an RFP

Seeing vendor presentations and demos before issuing the RFP will help your treasury team understand what the available capabilities are, so they can determine their functional priorities. It can also help your team narrow the list of vendors they want to issue the RFP to and reduce the number of RFP responses to review.

7. Collaborate closely with the chosen vendor to build a strong business case

Finally, and perhaps most importantly, there is the matter of preparing a business case for the acquisition of a TMS. What are the many factors to consider in the calculation of return on investment (ROI)? What can be measured and quantified in hard currency? What are the intangibles that can't be quantified but will provide major benefits to the company? Working with a system provider who can help you make these assessments and create a business case for acquiring a TMS can greatly assist you during your selection process.

If you perform your TMS selection process in a linear fashion, it might take you 6-9 months. And more than half of that time could be taken up by an inefficient RFP process that won't bring you any closer to a decision and is more of a requirement of the internal buying process than a useful tool. If you can speed up that process by customising your RFP, and running other decision-making processes in parallel, you may shorten the time to value of the end solution and start saving money sooner.

Crown World Mobility Moves Payment Mountains with Kyriba Citing a 20% Productivity Increase

Managing an increasingly mobile workforce creates challenges for any organization. There are policies to navigate, formalities to coordinate and compliance requirements to be met – at the same time as concentrating on a new role and getting the day job done. Crown World Mobility helps corporations manage their global talent programs by enabling individuals to relocate through a fully integrated suite of world mobility services.

Optimizing the Outsourced International Payments Process

A rapidly expanding part of Crown's service is outsourced expense payment and treasury solutions. When Crown World Mobility first offered this service it executed payments largely through manual processes based on spreadsheets and web-based electronic banking systems. This created a number of risks and compliance challenges and was insufficiently scalable in meeting client demand as well as the growing complexity of managing client funds across multiple geographies, currencies and payment products.

Crown required a secure, scalable and efficient solution that would enable them to offer an innovative and professional service to clients, reducing the non-productive global mobility costs of delivering payments worldwide.

Identifying the Right Solution

Crown met with SWIFT and attended a workshop on cash and treasury management technology. It was decided that the payments and cash management team required a solution designed to support the needs of a payment factory, to align with how the function was developing. So in evaluating multiple vendors for security, scalability and efficiency gains, Crown also sought to implement a solution

CROWN WORLD MOBILITY

Parent Company:
Crown Worldwide Group
Founded: 1965
Headquarters: Hong Kong
Industry: Mobility
Revenue: $697m
Purchased Kyriba: 2016

"Kyriba is integral to enabling us to become an entrepreneurial, automated treasury. We can confidently attribute a 2016 non-productive cost saving for our clients of over USD$1.7m."

—Matthew Crockett,
Director of Finance & Technology,
Crown World Mobility

QUANTITIVE RESULTS

20%
Overall productivity increase

92%
Time savings on payments execution

$1.7m
Non-productive client cost savings in 2016

65-95%
Cost savings on payments fees

88%
Time savings on payments reconciliation

$80k
Payments cost savings for clients in 2016

with a local presence in Hong Kong and without large technical overheads – Kyriba was deemed the only supplier to meet these needs and provide a truly cloud-based solution which met European data privacy storage compliance requirements.

> "Kyriba offered superior support and its consultative approach has proved invaluable throughout the project in supporting both operational and strategic objectives."
>
> – Matthew Crockett,
> Director of Finance & Technology at Crown World Mobility

Achieving the Vision, Measuring Success...

The Crown World Mobility team first completed a pilot implementation for a single entity and has since rolled out the solution to three further clients. The most immediately tangible result was the reduction in time and resource required to execute payments. For example, the time taken to prepare, approve and transmit payments has dropped from 3-4 hours to 20 minutes; reconciliation has been reduced from 4 hours daily to around 30 minutes.

Altogether the team has achieved a 20% productivity increase, saving 1 full-time headcount whilst improving quality and accuracy.

Previously additional staff were required for each new client, whereas now they have the capacity to support both existing and additional clients without further recruitment.

with no manual intervention required. Transaction controls, such as authentication and approval take place in Kyriba before release to the bank, without users requiring access to the banking system directly.

Through the automatic selection and set-up of optimal payment methods predetermined by Kyriba, including SEPA and Global Disbursement ACH, Crown has been able to achieve payment cost savings exceeding USD$80k per year for its clients, reducing the cost of some payments by 65-95% without additional labour overheads.

Moving Forward

The Crown team will be exploring how the solution can support a wider range of services to customers, including funding linked to overdrafts. Kyriba is a strategic and essential platform on which to grow the business; It will continue to be a catalyst for further optimizing the payments and cash management processes, making better use of the data to create more sophisticated and informative business intelligence.

A Non-Financial Crisis

Matt Tottenham
Director, Risk Strategy and Technology,
KPMG Australia

Whilst the Global Financial Crisis began as a liquidity, market and credit dislocation – after the immediate economic issues subsided it was clear that another crisis was underlying the financial industry – a crisis of culture, governance and accountability.

Whilst the Global Financial Crisis began as a liquidity, market and credit dislocation – after the immediate economic issues subsided it was clear that another crisis was underlying the financial industry – a crisis of culture, governance and accountability.

Australia, on a relative basis, managed well through the financial repercussions of the GFC, with our prudential stability and financial management respected globally. However, a range of poor risk management and conduct issues have most recently been exposed through the Royal Commission, significantly damaging trust in the industry.

Preceding the Royal Commission but addressing many of the issues head-on, APRA's Prudential Inquiry into CBA, explored the root causes of how a bank of such high standing such as the CBA, could have allowed such behaviour or incidents to occur. The findings and recommendations around frameworks, operating effectiveness and culture have informed industry inside and outside of financial services.

So what did we learn from the global experience?

In the global financial centres, response from the general public and their elected representatives was severe, with regulators accused of not policing the industry adequately. This was swiftly followed by funding increases to bolster regulators' capabilities, and broad political support and demands for them to take a stronger position. Oversight and pressure increased substantially – and significant new regulation in the US, Europe and US has been implemented. Estimates of fines received by the global banking industry rang up to and greater than $300B USD.

As part of this acute pressure to manage risk more effectively, a number of key components of the risk management framework evolved substantially at global firms – and continue to do so. These themes are instructive given Australia's current challenges, and are reflected in APRA's Prudential Inquiry into CBA.

The Board's Role, has become far more prominent, albeit posing challenges in maintaining a working line between governance and management. Boards are increasingly expected to have a public and internal voice, to set their expectation and tolerance for risk, and to emphasise the importance of integrity. They need to **trust their executive team, but have measures to verify this trust.** For example, to provide additional data points outside their formal executive updates, Boards internationally have supplemented existing formal committees with informal and occasional opportunities to meet with risk owners. These allow Board members to gain a better understanding of specific risks, understand how management monitors these risks on a day-to-day basis, and agreeing from an informed position as to what makes sense for a Board member to monitor. Existing aggregated or averaging risk metrics can be **substituted with more meaningful and pinpointed measures that can highlight emerging risks more quickly**, minimizing reputation risk.

Accountability has become a core focus, with a swing toward ensuring that business owners ('first line') own their offering end-to-end. Increasingly business heads are tasked with making sure that they and their firms have in place everything they require to adequately manage the inherent risk in their business: **no matter who they are dependent on.** Arguably these business heads wield the most influence within organisations, so pairing their typically higher compensation with unambiguous accountability for oversight aims to **minimize the risk that something 'falls between the gap**' between the many divisions and functions that ultimately support a business. Boards are asking: do we set the tone that my business heads are fully accountable? Do our business executives have enough authority to influence those they are dependent on, or is this accountability in name only? Does the way we engage the Executive send a clear message that 'first line' or business is on the hook? Have any of our Executives ever been penalized for 'dragging their heels' on managing risk or do we only wait for outright misconduct to act?

The role of **Compliance** has also evolved significantly. Initially a role that historically tried to eliminate risk by carefully checking against regulatory or legal compliance (i.e. "can we" do this), the role at most global institutions is **now expected to assess and manage risk** by asking the question: "should we" do this? This has them effectively playing the role of the independent ethical challenge within organisations, and has a number of implications that Boards are increasingly considering. Are the key people in this role equipped for the new expectations? Are they properly interleaved in the organisation's decision-making processes including strategy and investment governance, or are they confined to more operational activities? Does this ethical "release valve" (Compliance or an equivalent) have a genuine line to the Board to provide them that alternative viewpoint which will protect the Board when it really matters?

Risk Culture (or at least firm culture as it pertains to managing risk) needs to be assessed multi-dimensionally across the organisation, and will typically need more than a staff survey. What does the Board and Executive team think and communicate to the rest of the organisation? Subsequently, what does Middle Management hear, and **how do the actions of those above them influence them to act, irrespective of the official communicated corporate 'values**'? What are the competing pressures in middle management that might create conflicting incentives? In addition, what do the rest of the staff perceive, and **do they see management walk the talk?**

Linked to accountability are the complexities of **remuneration and incentives**. Global financial institutions have increasingly adopted deferred compensation including malus and clawback policies that allow them to **apply consequences in the future for today's poor behaviour.** Risk measures in scorecards and risk modifiers are becoming standard, and Risk division input into compensation is being used to demonstrate that f**inancial performance at all costs has a counterweight.** Board members are evaluating - does my Remuneration Committee have Risk representation? Is Risk input on compensation limited to Group Executives only? Are risk considerations in my performance and remuneration structures balanced enough with incentives for financial or operational performance? Will our incentive structure lead our staff to prudent risk/reward trade-offs, or are they actually structurally geared to encourage risky behaviour?

Boards and Executives are seeking assistance to evaluate how their firms' shape up to these themes and questions that were identified in the APRA CBA Inquiry, as well as during the Royal Commission. There is a significant multi-year journey ahead of the financial services industry, but a **wealth of experience from other jurisdictions that are further down this path.** As the industry collectively reflects and many firms highlight their gaps – careful thought should be given to the remediation efforts that are proposed. Are these proposed changes realistic? Are they sustainable or will they deteriorate when profits are challenged? **Are we comfortable that we can achieve these in a sensible timeframe given the likely increase in oversight anticipated?**

Finally – whilst Financial Services responds to the intense pressure to reform, a number of **non-financial sector organisations** are using this opportunity to assess their own operations. Many, if not all of the findings have a parallel outside financial services, and addressing these proactively before problems arise has obvious financial and reputational benefits.

Matt has 25 years of experience, predominately working in banking across New York, London, Hong Kong and Singapore. He ran Strategic Change before, during and after the financial crisis and gained invaluable insight as to how risk management has evolved over that time. In this article, Matt provides his views on a number of key themes that have emerged in the Australian market, and which KPMG believes are important for Australian firms to consider.


JOIN LEADERS AT ALL LEVELS OF YOUR FINANCE AND TREASURY CAREER
FTA
FINANCE & TREASURY ASSOCIATION
We've developed memberships options to kick start your career, get you ahead and be beneficial at all stages of your working life.
We even want you to keep engaged once your career is over and become a mentor and professional role model to this future profession.
www.financetreasury.com.au

Most Corporates Resilient to 200bp Rate Rise, but Cracks Appear Under 400bp Scenario

Interest Rate Stress Scenario: APAC Corporates

Matt Jamieson
Senior Director

Head of APAC Research
Corporate Ratings Group, Fitch Ratings

A stress test of Fitch Ratings' Asia-Pacific (APAC) corporate portfolio comprising 288 credits shows that 90% of issuers could comfortably cope with a 200bp rise in borrowing costs. This reflects the unnaturally low interest-rate environment that has persisted over the previous five to 10 years and reinforces our focus on refinancing as one of the key risks to credit quality. However, 18% of issuers would see their interest coverage ratios fall below 1.5x if rates were to jump by 400bp.

We see the current period of low interest rates as cyclical – a response to the legacy of the 2008 global financial crisis – rather than structural, and expect real interest rates to gradually normalise. Interest rates have already been hiked in economies such as Indonesia, India and the Philippines during 2018 and the US Federal Reserve's rate-hiking cycle is not over. The 10-year US treasury rate is at 3.15%, while core CPI is at 2.20%, translating to a real rate shy of 1.00%, which remains well below potential US growth of almost 2.00%.

The US Federal Reserve is likely to steadily increase its official rate by 100bp to 3.25% by the end of 2019, from 2.25% currently. The table below shows that, so far, the greater response in APAC to higher US rates has been local-currency depreciation, particularly in Australia, India, Indonesia, China and South Korea. Rising interest rates have, more generally, created upward pressure on the US dollar and have generated financial market volatility, all of which may continue as global monetary tightening progresses.

	USD in Local Currency			Benchmark Interest Rates		
	End-2017	October 2018	Change (%)	End-2017 (%)	October 2018 (%)	Change in bp
United States	1.00	1.00	0.0	0.75	2.25	150
Australia	1.28	1.40	9.4	1.50	1.50	0
China	6.53	6.92	6.0	4.35	4.35	0
Hong Kong	7.82	7.84	0.3	1.00	2.50	150
India	65.08	73.93	13.6	6.00	6.50	50
Indonesia	13,721	15,229	11.0	4.25	5.75	150
Philippines	49.95	53.99	8.1	3.00	4.50	150
South Korea	1,070	1,128	5.4	1.50	1.50	0
Thailand	32.57	32.68	0.3	1.50	1.50	0

Source: Fitch Ratings, Fitch Solutions, Bloomberg

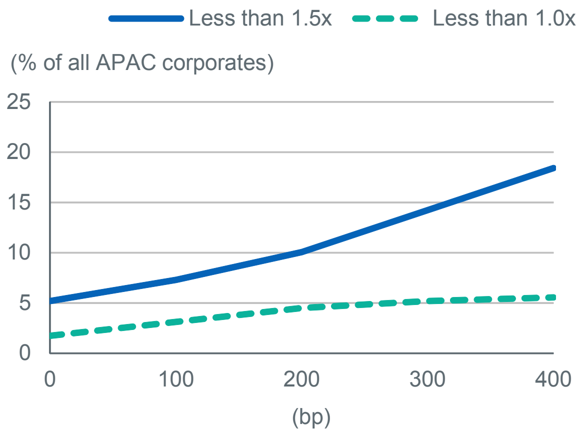
Central banks across APAC are likely to take a gradual and varied approach to increasing rates. Nevertheless, we have stressed our portfolio assuming an immediate rise in borrowing costs across the entire debt stock to gauge the impact on companies' interest-coverage ratios.

Speculative Grade Credits Most Vulnerable

A 200bp stress on our forecast projections for 2019 would leave 29 credits, or 10% of our sample of 288 APAC corporates, with their EBITDA not covering 1.5x of their interest expense, compared with 15 credits currently. However, under a 400bp stress, 18%, or 53 credits, would have interest coverage below 1.5x and 6%, or 16 credits, would have a coverage ratio of less than 1.0x. This would leave the companies with little room for underperformance or capex, assuming unhedged exposure.

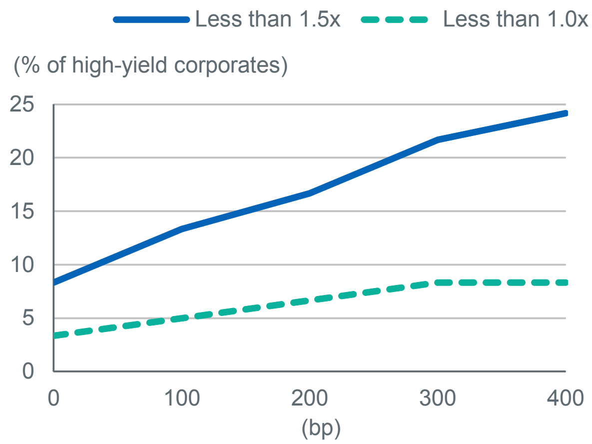
Most of the companies that would see a fall in their interest-coverage ratios to below 1.5x are in the high-yield rating category, of which there are 120 credits in our portfolio. The 200bp stress would leave 23 'B' category credits with coverage ratios of less than 1.5x, of which 10 would have coverage ratios of less than 1.0x, and three 'BB' category credits with coverage ratios of less than 1.5x. The number of corporates with coverage ratios below 1.5x under the 400bp stress would expand to 33 'B' category credits, 13 'BB' category credits and four 'BBB' category credits.

Interest Rate Shock: All APAC Corporates
2019F EBITDA interest-coverage ratio



Source: Fitch Ratings, Fitch Solutions

Interest Rate Shock: High-Yield Corporates
2019F EBITDA interest-coverage ratio

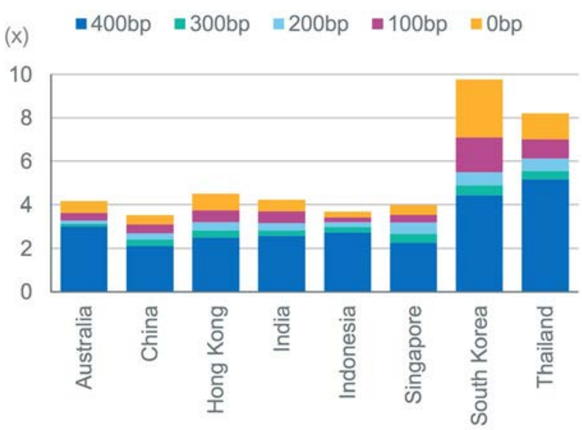


Source: Fitch Ratings, Fitch Solutions

Low Interest Coverage in China's RLCP, Utility and Property Sectors

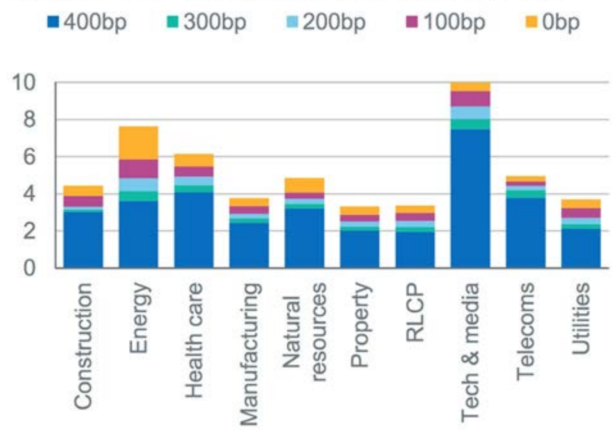
By country, corporates in China appear the most exposed in terms of the lowest coverage ratios under an interest-rate shock, with their median coverage ratio falling to 2.1x, from 2.7x, under the 400bp scenario. Corporates in Hong Kong have the widest movement, with the median interest-coverage ratio falling by 1.3 turns, to 3.2x, under the 200bp scenario and by 2.0 turns, to 2.5x, under the 400bp scenario. This is followed by corporates in Singapore and India, where the median coverage ratio under the 400bp scenario falls by 1.7 turns and 1.6 turns, respectively.

Interest Rate Shock by Country
Median 2019 EBITDA interest-coverage ratio



Source: Fitch Ratings, Fitch Soluitons

Interest Rate Shock by Sector
Median 2019 EBITDA interest-coverage ratio



Source: Fitch Ratings, Fitch Solutions

By sector, energy stands out, with its median interest-coverage ratio falling by 2.8 turns, to 3.8x, under the 200bp scenario and by 4.0 turns, to 3.6x, under the 400bp scenario. However, the most-exposed sectors in terms of the lowest coverage ratios under the 400bp shock scenario are retail, leisure and consumer products (RLCP), with the median ratio falling to 2.0x, from 3.4x, property, falling to 2.0x, from 3.3x, and utilities, falling to 2.1x, from 3.7x.
Eleven homebuilders in the property sector have interest coverage of below 1.5x under the 200bp shock scenario and a further six under the 400bp scenario. However, the risk to homebuilders comes from refinancing ability rather than interest servicing capacity, and accordingly, we place greater emphasis on funding costs and net debt/adjusted inventory leverage when assessing homebuilders' financial profiles. The funding costs of 'B' rated Chinese homebuilders has already expanded by over 500bp over the previous twelve months, but their EBITDA margins have also widened along with rising home prices between 2H16 and 1H18.

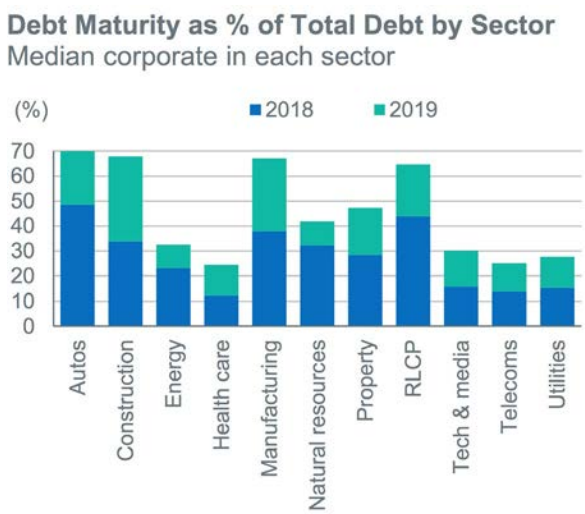
Outside of the property sector, 10 utility-sector and five RLCP-sector corporates would end up with interest-coverage ratios of below 1.5x under the 400bp interest-rate shock scenario. The utility-sector corporates include regulated network assets in India, where low interest coverage is normal and ongoing regulatory resets would take into consideration higher interest rates. In addition, interest-coverage ratios for certain utility companies in China have fallen due to large-scale debt-funded capex in the previous few years.

Higher Refinancing Risk - Construction, Manufacturing and RLCP Sectors

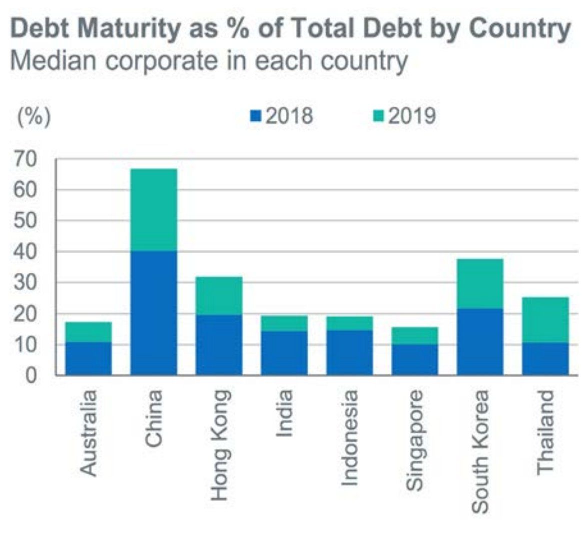
The portfolio's resilience to our interest-rate stress scenario can be explained by the average APAC corporate's balance-sheet strength in conjunction with the current low interest-rate environment. Financial leverage, as measured by net debt/EBITDA, has been on a declining trend for the overall portfolio, falling to 2.0x in 2018F, from 2.3x in 2016. This was helped by lower capital expenditure outlay and rising commodity prices contributing to positive free cash flow generation. Fitch forecasts the portfolio's leverage to edge down further to 1.8x by 2020.

Nevertheless, certain sectors appear more exposed to refinancing risk under a higher interest-rate scenario than others. Corporates in the construction and engineering, manufacturing and RLCP sectors are the most vulnerable, with the median company required to refinance more than half of its outstanding debt over 2018 and 2019. Auto companies would also be exposed due to a large proportion of their overall debt stemming from their financial service operations, which typically rely on short-term debt.

By country, Chinese corporates are heavily exposed to short-term debt maturities due to reliance on short-term debt from Chinese banks and capital markets. However, this may not be an issue for large strategically important state-owned corporates, whose short-term loans are typically rolled over by local state-owned banks. On the other hand, privately owned entities may experience some difficulties, particularly if the credit environment were to tighten significantly.



Source: Fitch Ratings, Fitch Solutions



Source: Fitch Ratings, Fitch Solutions

Methodology

The findings presented are based on a sample 288 corporates rated by Fitch across APAC. The interest coverage metric used is the EBITDA fixed-charge coverage ratio, using EBITDA plus rental/leasing expenses as the numerator and gross interest expense plus rental/leasing expense as the denominator. The analysis assumes interest rates will rise by the stressed amounts – 200bp and 400bp – from each corporate's effective interest rate as per its most recently completed financial year. We have assumed all interest is variable for the purpose of this exercise.

finncetreasury.com.au

Level 3, 480 Collins Street
Melbourne VIC 3000
Australia