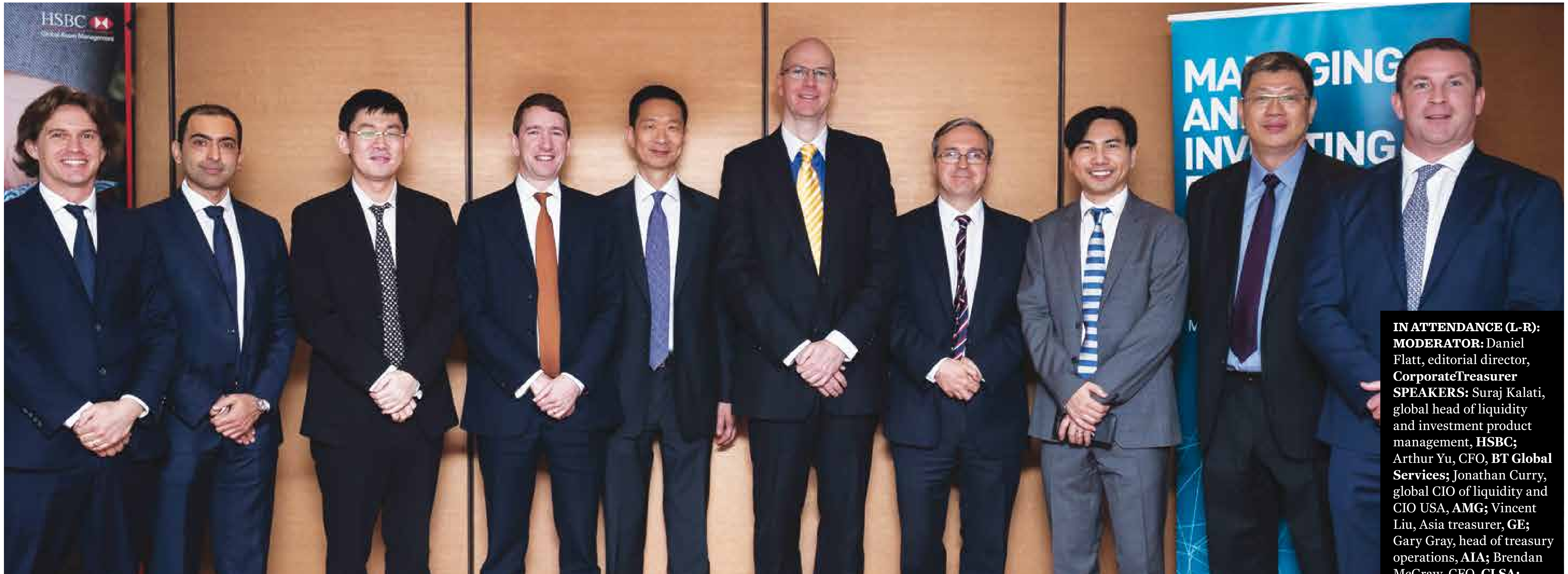

IN ATTENDANCE (L-R): MODERATOR: Daniel Flatt, editorial director, **CorporateTreasurer SPEAKERS:** Suraj Kalati, global head of liquidity and investment product management, **HSBC;** Arthur Yu, CFO, **BT Global Services;** Jonathan Curry, global CIO of liquidity and CIO USA, **AMG;** Vincent Liu, Asia treasurer, **GE;** Gary Gray, head of treasury operations, **AIA;** Brendan McGraw, CFO, **CLSA;** William Poon, director of Asia financial shared services, **Burberry;** Kenneth Ng, group treasurer, **DFS;** Simon Bourke, director institutional business, liquidity, Asia-Pacific, **AMG**

MANAGING AND INVESTING YOUR EXCESS LIQUIDITY

In a roundtable hosted by HSBC Global Asset Management (AMG) and Corporate Treasurer, leading lights in treasury discuss how they have adapted their liquidity management strategies to both global and local regulatory change.

Basel III has had a dramatic effect on the banking system since it came into being in 2011. The measures, which focus on financial institutions' management of capital, liquidity, and funding levels, were developed by the Basel Committee with lessons from the global financial crisis squarely in mind.

As part of the reforms, the Basel Committee wanted banks to distinguish between two types of short-term deposit – operating and non-operating. Make no mistake, this distinction is having a profound effect on the relationship between banks and corporate clients – notably on how the latter manage liquidity.

To understand why, it's important to know how the Basel Committee defines both forms of deposit and how banks have to respond to either.

Basell III considers operational cash – which includes general working capital and cash held for transactional purposes – to be stickier than non-operational cash. Because of this, a bank only has to hold liquid assets equal to 25% of operating deposits on the sheet.

"WE'VE TAKEN POCKETS OF LIQUIDITY... AND PUT IT INTO ONE POT. WE THEN USE IT AS A CENTRAL RESOURCE TO PAY DOWN DEBT OR INVEST"

On the other hand a bank will need to hold the equivalent of 40% of non-operating deposits, which are defined as cash balances not immediately required by the depositor's business and therefore is susceptible to run.

On these grounds, financial insitutions are more likely to search for clients with more stable forms of operational deposit on hand. In essence, companies with large transactional flows, high volumes and which regularly use bank products will more likely have a greater percentage of deposits classified as operating.

It follows therefore that companies with limited flows, more volatile balance sheets and less need for complex bank products get classed as non-operating. Bank demand for this type of deposit immediately lowers with the expected increase in costs associated with it.

As Corporate Treasurer warned in late 2014, the age-old banking model of building a deposit base for free (or near enough) in order to offer loans has changed forever. If they weren't already, global commercial banks were almost certainly gearing up to start charging for the privilege of having their customers park their cash with them.

HSBC Global Asset Management (AMG) and Corporate Treasurer brought together some of the region's most influential treasurers to discuss how regulatory change has affected the development of their liquidity management strategies. The Managing and Investing Excess Liquidity Roundtable was hosted recently at the Mandarin Oriental in Hong Kong.

CENTRALISE OPERATIONS

For Brendan McGraw, CFO of CLSA, the creeping effect of low interest rates in general and diminishing returns on deposits meant the Hong Kong-headquartered brokerage and investment firm chose to centralise its liquidity across the region through the use of cash and notional pooling.

"We've taken pockets of liquidity – anywhere that doesn't have a restricted currency, Australia, Singapore, Hong Kong, Japan – we put it every day into one pot. Then we use it as a central resource to either pay down debt or to [invest] in liquidity products."

McGraw's position is not uncommon and the frustration is is exaggerated somewhat by the fact local regulators all have differing interpretations of the Basel Committee's distinction between operating and non-operating deposits.

Because of this, CFOs and treasurers of multinational companies cannot assume what works in one country will be the same in another.

Asset managers are seeing this too. "From an internal standpoint within the banks ... for the past 18 months to two years, there's been a balance-sheet-reduction campaign which banks have done very well on," explained Simon Bourke, director, institutional business, liquidity, Asia-Pacific, AMG. "It's the non-operating component that's been targeted in particular, and there has been a noticeable uptick in off-balance sheet solutions."

"[As a result] people have to spend more time managing cash and liquidity than they did historically," added Jonathan Curry, global CIO of liquidity and CIO USA for AMG. "There was a ready demand from banks for short-dated funding and no-one thought there'd be a day when banks would turn away money." Precisely for this reason companies such as GE are also simplifying the way they manage their banking relationships. This, in turn, moves them to manage liquidity in new ways.

Vincent Liu, GE's Asia treasurer, explained: "Precisely because, at least for the time being, operational cash is viewed as liquidity, we bank with much fewer

"CARRYING LIQUIDITY PRE-CRISIS WAS A FREE OPTION AND THERE WAS OPPORTUNITY COST TO INVESTING. IT'S A DIFFERENT SCENARIO NOW"

banks – usually big global providers – and leave cash with them. Of course it's all under the auspices of leaving as little cash as possible and centralising liquidity management wherever we could, but the regulation does drive us toward using fewer banks, using global banks."

Hopefully bank rationalisation will increase your chances of receiving a more comprehensive service from your key partner banks. "You will see where you provide operational cash to banks, it opens up wider services that banks can offer. However, there's clearly more segmentation around your liquidity and segmentation based on the industry you come from," explained Suraj Kalati, global head of liquidity and investments product management at HSBC.

A downside to this is that not all global banks necessarily have the reach and depth in the local markets where large companies like GE operate. That said, Liu also works to a very strict investment policy which limits the investment opportunities the company is prepared to enter into.

"We're talking just bank deposits, money market funds. Protection of the principal is the core tenet, therefore liquidity mobility within a country or a region, so once we've made that strategy choice, there's no point chasing yield," Liu said.

For those more in need of squeezing out that extra yield, AMG's Curry is seeing corporate investors start to look at a broader range of investment options. He said it is possible to benefit from regulatory arbitrage with a particular bank in a particular country, where certain regulators allow them to treat very short-dated funding as long-term money.

"Investors are looking to leverage their banking relationships more, but also they are thinking about how much liquidity is enough to be comfortable at the board level. Carrying liquidity pre-crisis was a free option and there was an opportunity cost to investing. It's a different scenario now."

For treasurers in businesses focused on asset liability management, such as insurance, the need to make cash work hard is a critical aspect of the job. Unfortunately broadly low interest rates means leaving cash in standard deposits is not that helpful to them.

Ironically, in the case of an insurance company a lot of the cash on hand would sit nicely under the definition of operating deposit. As such banks have been keen to target them and offer slightly better deposit rates. But whether that is enticing enough is another matter.

According to Gary Gray, head of treasury operations, at AIA, the company's general finance direction has been to minimise cash balances to avoid leaving money on the table. "Even before Basel III, with interest rates so low, if we were sitting on deposits of $1 billion earning 50 basis points, versus investing that longer-term with higher interest, that's a significant amount of opportunity cost."

AIA's focus now is on minimising cash balances group-wide by focusing on cash management and forecasting. In the past AIA was happy to employ a lot of short-term fixed deposits, but it has moved more and more into money market funds and other alternatives.

"We really only look at cash as a one or two day hold," said Gray. "It's not like we're looking for go to market and leave a deposit for three months."

Unlike CLSA or GE, there is less need for an insurance company to centralise liquidity in one place. It can invest in local markets and match its liabilities, because it is collecting its premiums locally too. That said, local markets such as Vietnam may not offer the same standard of investment products; it can be tricky to find the right vehicle to park your cash into.

GOOD CASH VISIBILITY HELPS

This is where forecasting plays a crucial role in an insurance company's operational and risk management setup. For Gray, operating off one global treasury platform – SAP – which he says can provide far greater visibility of its cash position and investment exposures.

Even in more tradtional market sectors such as the fast-moving consumer goods space, a highly developed liquidity management structure can make investing excess liquidity easier to achieve. For Kenneth Ng, group treasurer of DFS, quick access news, data, and analytics and also currency trading, settlement and execution via Thomson Reuters' Eikon and FXall platforms makes its easier for his team not only to trade in FX spot, forwards, swaps, but also, for example, to park excess cash into money market funds.

"WINDOW GUIDANCE"

Outside of global regulatory standards such as Basel III and Solvency II lies a host of local regulatory issues that keep Asian treasurers on their toes when it comes to investing excess liquidity.

"[IN CHINA] OUR REMAINING CASH HAS TO BE INVESTED. MONEY MARKET FUNDS GIVE US ALL THE FLEXIBILITY TO MOVE CASH IN CASE WE NEED TO"

In some cases, it has made the need for investment more urgent. A good example is China, where the central bank has in recent months more carefully controlled the levels of renminbi allowed to leave the country.

The tightening is a response to continued concerns that outflows of capital are weighing on the value of the renminbi but, as Corporate Treasurer reported in January, it has meant some large multinational companies have had to shelve plans to move cash offshore via cross-border intercompany lending mechanisms.

This has naturally had a knock-on effect on companies' liquidity mangement strategies, increasing the pressure on treasury to find internal solutions to support struggling markets. Assuming it is harder to use internal sources to push money cross-border, more local funding strategies may be the order of the day.

But that doesn't mean those sitting on stockpiles of cash in China should just keep it in traditional deposits.

For companies with substantial operations in China such as clothings manufacturer Burberry and BT Global Services, which provides IT and network solutions, there is a need to both find suitable ways to keep money flowing out of the country to their other businesses and to invest the rest of the cash either in operations or to earn extra yield. According to Arthur Yu, CFO of BT Global Services, the process of moving cash out of China is onerous. "We work in a heavily regulated industry. To repatriate, there is a lot of constraints and paperwork required – you need to go through the local tax bureaus, the state tax bureaus etc etc," Yu said.

For William Poon, a director of financial shared services for Asia at Burberry, moving cash out is less of a bureacratic strain. But he agrees the opportunities – such as intercompany loans or business service fees – have narrowed, though traditional methods such a dividends are still accepted.

Poon said: "Liquidity is very important for us, the remaining cash [in China] has to be invested. We don't want to have any investment that will slow down our liquidity, so no more than six months. Money market funds (MMFs) gives us all the flexibility to move cash in case we need to.

"It's quite straight forward to put into MMF [in China] and earn some yield on the excess funds," Poon said. "We have an investment policy. The fund we invest in must be triple-A rated. And it must be international ratings."

For more information about HSBC Global Asset Management liquidity capabilities, please visit: www.globalliquidity.hsbc.com/asia/hong-kong/contact-us

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