London as a Centre for Management of Financial Risks

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CITY OF LONDON

Contents

Foreword

With the rapid pace of technological change and innovation, coupled with developments in the global political and economic landscape, multinational corporates are operating in an increasingly complex environment and are exposed to a diverse range of risks.

As a global financial and professional services hub, the UK is well-positioned to help multinational corporates navigate and mitigate these risks.

The UK has a highly liquid and international capital market, with long-standing strengths in facilitating cross-border banking activities. With a strong network of 250 international banks, the UK channels 43% of global forex trading and 18% of international bank lending. Such high volume of cross-border financial transactions is testimony to the UK's capability to support multinational corporates in managing currency and liquidity risks on a global scale.

Multinationals are also facing a growing need to control their interest rate risks amidst shifting prospects for growth and monetary policy worldwide. The UK, a leading derivatives market with 50% share of the trading of global over-the-counter interest rate derivatives, could offer multinationals suitable tools to help them hedge interest rate risks.

Global multinationals can also leverage on the UK's diverse and mature insurance market to manage their business and specialist risks. The UK is home to Lloyd's, the world's largest and most mature specialty insurance market, which helps corporates diversify their risks through its international reach in over 200 countries worldwide. London is also the only place where every top 20 insurance and re-insurance firm is active.

Furthermore, multinationals could also control their operational risks and ensure regulatory compliance with support from leading legal, accountancy and consulting service firms gathered in the UK. The UK is home to the Magic Circle law firms, has a strong presence of the Big Four professional services firms, and has a 7% share of the global management consulting market.

The UK's stringent regulatory standards are world-renowned, and the UK is committed to global regulatory coherence as both a public good and an important business imperative. The UK recognises that such coherence is of critical importance to global corporates operating across multiple markets.

The UK's advantageous time zone with working hours overlapping major markets from East to West, its supply of 2.3 million people talented in financial and professional services, and its forward-looking regulation, global connectivity and international outlook are all valuable assets to helping multinationals succeed in today's rapidly evolving and increasingly interconnected world.

As a leading global financial services centre, the depth and breadth of the UK's offer provides unparalleled opportunities for multinational corporates to grow.

William Russell
The Rt Hon
The Lord Mayor of
the City of London

Catherine McGuinness
Chair of Policy and
Resources, City of
London Corporation

Sources: The Association of Foreign Banks, Bank for International Settlements, TheCityUK, Lloyd's of London, Consultancy.uk, International Underwriting Association

Future of multinationals:
corporate treasury as a key driver of risk management

In today's business world, multinationals are becoming increasingly global in their geographical reach, scope and outlook. They are also fundamentally rethinking how to most effectively mitigate a range of new risks arising from growing cross-border networks and activities.

Geopolitical instability remains a top concern for multinationals, according to a recent report by the insurance firm Marsh, which identifies protectionist sentiment, trade tariffs, geopolitical disputes, elections and growing political volatility as key considerations.

These geopolitical uncertainties directly influence financial market sentiment, creating financing and liquidity risks for multinationals. Uncertain political and business sentiment is also increasing the volatility of forex and commodity markets, highlighting the urgency for multinationals to manage their financial risks.

Meanwhile, more stringent regulations and the risks of regulatory fragmentation across different markets is causing multinationals to manage their compliance risks. The rise of cybercrime is also an increasingly significant risk that corporates must address.

Amidst the challenge of growing risks, one business function that has risen to tackle these new challenges is corporate treasury. A relatively new function born in an era of growing financial uncertainties in the 1970s, the corporate treasury function has fast evolved from that of a data provider which aids financial reporting into a critical support for corporate strategic planning and risk management.

Corporate treasury functions vary in size and complexity. A simpler treasury function may focus on centralising and managing operational cashflows, to ensure that liquidity needs are met and foreign exchange risks are managed. A more sophisticated corporate treasury functions like a strategic bank within a multinational, in charge of enhancing operational efficiency, leveraging new technology, optimising capital efficiency, and most importantly managing key risks from a central location.

Meanwhile, advances in treasury technology, improved banking infrastructure, and the rise of network computing have made the processing, recording, and reporting of financial data and transactions more transparent and efficient. These developments made it increasingly possible and easy for corporate treasurers to assess, recognize and mitigate risks.

Rising risk levels caused by financial market turbulence, especially since the 2008 global financial crisis, has elevated the corporate treasurer's role and responsibilities.

The Association of Corporate Treasurers' 2018 survey found that for the first time risk management became the topic corporate treasurers are expected to report to their boards about, ahead of more traditional treasury responsibilities such as corporate strategy and liquidity management.

As corporate treasury has risen in strategic importance, so has the decision of where to locate the corporate treasury function. Traditionally, treasury centres of multinational companies resided in the same country as their corporate headquarters for proximity to senior management. As companies expanded geographically, it became difficult for a single treasury centre to manage capital and risks specific to local markets, and many corporates began to establish regional treasury centres.

Sources: The Association of Corporate Treasurers, TheCityUK, Marsh

The UK is a popular location for multinationals to base either their central or regional corporate treasury centres, due to its liquid and deep capital markets, unparalleled forex flow volumes, leading insurance sector, advantageous time zone, the popularity of the English language and common law, and the abundance of skilled financial professionals.

Looking into the future, as technological advancement and automation bring innovation to the traditional banking sector, corporate treasurers also need to rapidly reinvent their ways of working. The availability and improved accuracy of data often means that, particularly in the area of cash flow, organisations are able to identify risks more clearly. This in turn enables treasurers to respond to risk management solutions and mitigation strategies more quickly and effectively.

The UK's unique combination of finance and technology expertise can support the corporate treasurer to pioneer new ways of working, and in turn empower fast-growing multinationals to respond to new opportunities faster while reducing exposures to all types of risks.

The future-proofed treasurer will be working at the cutting edge of risk management. As the business world becomes ever more systematic in how it identifies, assesses and mitigates financial risk, the treasurer's contribution will become invaluable. In order to be most effective in all these matters, a corporate treasury should be located in an optimal location and environment. London provides an excellent location for a treasury centre, and also an attractive market for treasury business, whether a company has operations in the UK or not.

The UK as a hub for financial risk management

Most multinationals use global financial centres and the financial instruments and services they offer to manage risks. London's deep capital market, wide range of financial instruments and global reach puts it in a prominent position to offer unparalleled support to multinationals.

Liquidity risks and opportunities to raise funds

The most fundamental risk to a company is liquidity – the risk that it runs out of cash. Multinationals typically give the responsibility of liquidity management to their global or regional corporate treasury teams, who will secure adequate funds to meet the company's liabilities as they fall due, or invest excess cash to improve efficiency of capital. For this reason, corporate treasury teams are typically based in global financial hubs where they can easily borrow or invest capital.

Cash management

Companies' cash needs can fluctuate significantly on a daily basis, and timely access to short term cash is key to a successful cash management strategy. The UK is Europe's largest banking centre, with 250 international banks and a wealth of experience providing short term cash management products to global corporates. Products such as short-term overdrafts and credit facilities can help companies raise funds whilst cash deposit products and money market funds can help them deposit excess cash.

The diversity of cash management products in the UK means both large multinationals and smaller companies can find options tailored to their needs. As the biggest fintech hub in Europe, the UK also has a growing cluster of fintech firms, which are constantly creating new cash management products to meet the varied needs of global multinationals.

Many global multinationals already base their cash pooling functions in London, where they can access sophisticated products to centrally manage the cash resources of their international subsidiaries. This enables cash to be efficiently deployed in a group, minimising costs and maximising returns.

Corporate treasurers can improve visibility, control, cost and predictability of cash by evaluating and selecting the right banking partners and services, developing a robust and dynamic cash forecasting regime; and designing and implementing in-house banking, payment factory, pooling, and netting structures.

Raising capital

Issuing bonds is a popular way for corporates to raise capital, and the UK is one of the world's most popular markets for bond issuance and trading. With 39% of global secondary bond market turnover, the UK has a liquid and sizable bond market, which can well support corporates to raise capital through bonds.

As the world's biggest forex market, the UK can also well support multinationals to issue bonds in the currency of their choice, to suit the local needs of their international subsidiaries. Euro and dollar bond markets have long been established in the UK. In fact, over twice the amount of US dollars are traded in the UK than traded on the US foreign exchange market, and more than four times the amount of euros are traded in the UK than in all euro-area countries combined.

More recently, the UK has become the largest offshore renminbi hub outside China, accounting for 44.5% of offshore forex transaction in RMB. This deep pool of offshore RMB transactions support businesses that are looking to list renminbi denominated bonds. As of the end of May 2019, there are 101 Dim Sum bonds listed on the London Stock Exchange with an outstanding value of RMB27.63 billion, an average coupon rate of 4.38%.

Sources: The Association of Foreign Banks, TheCityUK, World Federation of Exchanges, Project Finance International, Long Finance, City of London Corporation, Reuters, Bank for International Settlements, National Audit Office, CBRE, Bloomberg

In addition to bonds, the UK's financial market also offers other debt instruments to support corporates raising capital, including trade finance, asset backed lending and private placements. This diversity offers corporates a choice of debt products that most suit their profile and needs.

The UK is increasingly a hub for global multinationals to finance their long term international projects. In particular, the growth of green and ESG aligned infrastructure projects financed through the UK is growing, thanks to the UK's strong green finance market, ranked first in the world for quality in the Global Green Finance Index 2019. 37 'green companies' have raised $7.7 billion on the London Stock Exchange, including 13 renewable investment funds.

In 2017 the UK accounted for 10.7% of the global project bonds market. The London Stock Exchange is home to over 480 infrastructure related companies with significant operations in more than 65 different countries.

The UK also offers unparalleled professional services support to businesses in all aspects of their debt and capital needs, helping borrowers and shareholders alike achieve their financing objectives. Debt and capital consultants in the UK have a deep understanding of the debt and capital markets and can provide comprehensive and integrated advice on related credit ratings, tax structuring, legal and transaction issues, working both in the UK and across borders. For example, in a venture debt funding situation this might include management presentations to market the company to debt providers, negotiating the terms and preparing forecast models.

Equity finance raising

Equity is a further source of capital for growing businesses, and London again provides a deep and capable market. In the first nine months of 2019 there were over sixty Initial Public Offerings, or other new issuances of stock, on the London Stock Exchange main market and Alternative Investment Market.

The London market is increasingly accessible to overseas companies, providing a wider set of equity finance options for the corporate treasurer. For example, the Shanghai London Stock Connect allows Shanghai listed firms to raise new funds in London by issuing Depository Receipts.

Whether equity or debt finance is preferred, the range of options available in the UK enables the corporate treasurer to add value by aligning the finance structure to the organisation's overall strategy

Currency Risk

Foreign exchange rate fluctuations can adversely affect asset values, profitability and cash flow. Exchange rates tend to be highly volatile compared to other market rates and prices. This means that many large non financial corporates need to take steps to minimise the risk of loss.

In particular, companies can reduce volatility of margins, earnings and cash flows by analysing key foreign currency risks, in order to determine strategic, operational and financial management. Some of these risks can be managed by processes, controls, and reporting. Others are dealt with by hedging solutions e.g. borrowing in different currencies, or entering into FX derivatives.

This is where the UK's wealth of banks and professional services firms can come together to help multinationals to manage foreign currency risk. The UK accounts for 43% of global foreign exchange trading, ahead of other international centres. The UK also has a very broad and deep market in currency derivatives, covering both common currency pairs and more unusual currencies via bespoke over the counter contracts. Multinationals can use derivative products to lock in forex rates for a time in the future when they are expecting to receive or make a payment in a foreign currency, to mitigate their exchange rate risk.

Operational risk/Technological risk

Operational risk

Operational risk includes risk associated with failures in internal processes, people and systems, or external events such as an economic downturn. Risk of fraud and human error can be reduced by implementing appropriate processes and controls and the UK's professional service firms are able to advise on such safeguards. From a human resources perspective, advisors can also help organisations to mitigate business continuity risk by assisting with succession planning and training. London's position as a financial centre means that there is a large pool of treasury professionals and expert advisers for businesses to choose from.

A third party may be better able to manage a material operational risk, and such risks may be transferred by using insurance. According to Bloomberg, London accounts for as much as a tenth of the world's insurance and reinsurance market, which businesses located in the UK are well placed to access.

Technological risk

Technological risk relates to the capability and sustainability of a business' information technology. Errors or inadequacies relating to the robustness, integrity and security of a corporate's internal reporting systems could adversely impact the corporate's financial performance. Corporates can mitigate these risks by deploying the appropriate, bespoke and innovative technology systems. They could also use insurance to protect themselves against technological risks and use fintech solutions to enhance their technology systems.

Sources: The Association of Foreign Banks, TheCityUK, World Federation of Exchaanges, Project Finance International, Long Finance, City of London Corporation, Reuters, Bank for International Settlements, National Audit Office, CBRE, Bloomberg

The UK has Europe's largest concentration of technology companies and research from CBRE shows that London is the best-performing large tech cluster in the EMEA region. The UK is also Europe's leading fintech centre, accounting for over 68% of European Fintech investments in 2018.

The UK has a very strong offering of professionals and companies able to support business. These skills can be drawn on to design a bespoke system, or to assist as a subject matter expert on vendor assessment, project documentation and planning.

The UK's technology services sector also offers a comprehensive range of cyber security and data privacy services to help businesses to assess, build and manage cyber security capabilities and respond to incidents. The UK's cyber security market is the largest in Europe. It is valued at over £6bn, employs 30,000 people in the industry, and benefits from a supportive government with £1.9bn in cyber security investments committed by 2021.

Suitable cyber security solutions can help corporates shape their strategic response to risks, provide detailed technical analysis, address the legal issues around breaches and data privacy, and build a culture and environment where staff understand how to protect their company's information security.

Compliance risk

Businesses must comply with the relevant external financial reporting standards, legal and regulatory requirements. This includes an organisation's management of its legislative, advisory and litigation activities, including the development and renewal of, and compliance with, laws, regulations, international treaties/agreements and policies.

UK law firms and chambers can offer international expertise. Legal experts in business structuring and mergers & acquisitions can advise on everything from shareholder agreements to joint ventures and from limited liability partnerships and due diligence exercises to corporate simplification projects. Banking specialists can act for lenders and borrowers alike and can advise on refinancings, new facilities and intra-group lending arrangements. Firms with specialists in legal employment, intellectual property, corporate finance, debt advisory and transactions services can offer a seamless service with teams tailored to meet the specific needs of the business.

Professional services firms in the UK help businesses to manage accounting and regulatory change, achieve compliance and mitigate risk in relation to treasury or commodity risk exposures and transactions. They also help organisations to evaluate requirements and assist in the development of solutions for compliance with revised accounting standards and financial market regulations; and to develop accounting and disclosure activities.

The UK offer for risk management

43%

The world's biggest forex centre with **43% of global forex trading**

250

A global financial centre with **250 international banks**

£8.4tn

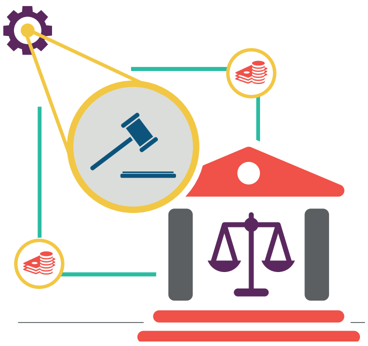
Largest banking centre in Europe, with **£8.4tn of banking assets**

50%

of global over-the-counter **interest rate derivatives traded through the UK**

27%

27% of the world's 320 legal jurisdictions are governed by systems based on English common law – by far the most popular choice for cross-border contracts



200

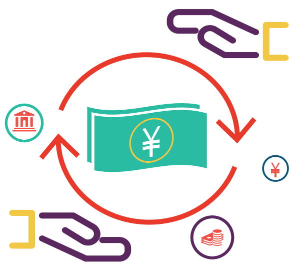
Home to Lloyd's, **the world's largest** most mature specialty insurance market, operating in over **200 countries worldwide**

20

London is the only place where every **top 20 insurance and re-insurance firm** is active, giving it unmatched global reach

44.5%

Biggest Western renminbi centre, accounting for **44.5% of offshore renminbi forex transactions**



Sources: The Association of Foreign Banks, Lloyd's of London, City of London Corporation, International Underwriting Association, TheCityUK, Bank for International Settlements

An international comparison

	UK	Germany	France	US	Hong Kong	Singapore
Size of stock exchange	**€4.4tn** market value of equity on main market at September 2019	**€1.5tn** market capitalisation of listed domestic companies at December 2018	**€2.1tn** market capitalisation of listed domestic companies at December 2018	**€26.6tn** market capitalisation of listed domestic companies at December 2018	**€3.3tn** capitalisation of listed domestic companies at December 2018	**€598bn** market capitalisation of listed domestic companies at December 2018
Share of global turnover from fx trading (April 2019)	43.1%	1.5%	2%	16.5%	7.6%	7.6%
Corporation tax rate	19%	15.9% plus 16*% trade tax (on trade tax assessable profits) (* varies by region, figure shown is for Frankfurt)	28% 28% for taxable result up to €500k and 31% for the exceeding portion. This is due to reduce to 25% by 2022	21%	16.5% 8.25% for the first HKD 2 million	17%
Share of global turnover from interest rate derivatives trading (April 2019)	50.2%	0.8%	1.6%	32.2%	6.0%	1.5%

Sources: London Stock Exchange, The World Bank, Bank for International Settlements, PwC

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