Issue

15

NOVEMBER 2011

Fifteenth Issue

INTERNATIONAL ASSOCIATION OF FINANCIAL EXECUTIVES INSTITUTES

IAFEI Quarterly

The electronic professional journal of IAFEI
(International Association of Financial Executives Institutes)

November 20, 2011, www.iafei.org
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IAFEI News

Letter of the Editor **November 20 , 2011**

Dear Financial Executive,

You receive the **Fifteenth IAFEI Quarterly**, the electronic professional journal of IAFEI, the International Association of Financial Executives Institutes. This journal, other than the IAFEI Website, is the internal ongoing information tool of our association, destined to reach the desk of each financial executive, or reach him, her otherwise, at the discretion of the national IAFEI member institutes.

High trade imbalances between major countries and ever increasing government debt in a number of states continue to put ever more pressure on currencies and financial markets, to the degree that they are moving again into crisis mode, on both sides of the Atlantic. Great political efforts are taking place, in big as well as in smaller economies, to stop state indebtedness from increasing further, or even to achieve a state debt stagnation or decrease again.

Financial tensions and limitations in the developed economies in Europe and America give rise to concern that the world my fall again into a recession sooner than otherwise would have to be expected. There is also confidence, though, that the emerging economies will continue to contribute robust growth to the world economy.

As a consquence, the challenges for the financial executives remain high and complex in this global multipolar world economy. This IAFEI Quarterly addresses some of these challenges.

Once again, I repeat our ongoing invitiation to IAFEI member institutes, and to their members, to send us articles for inclusion in future IAFEI Quarterlies, and to also send to us your suggestions for improvements.

This IAFEI Quarterly, again offers a variety of articles and subjects. Enjoy reading them.

Best personal regards

Helmut Schnabel

Helmut Schnabel

The CFO and his company

Willy Van Riet has been CFO of Wienerberger AG since April 1, 2007. He is responsible for corporate controlling, IT, treasury, risk management and investor relations as well as the industrial investments Tondach, Bramac and Pipelife. He has been active in the building materials sector since 1993, first as CFO of Terca Bricks Industries and later of Koramic Building Products. In 2004, he took over the management of Wienerberger Ltd in Great Britain before coming to Vienna as CFO of the group. Wienerberger is the largest brick manufacturing group worldwide with 234 plants in 27 countries. In 2010, the group boasted EUR 1.74 billion in total revenues and an EBITDA of EUR 210.8 million. The company was founded in 1819 in Vienna and has been traded on the Vienna Stock Exchange since 1869.

By Sabine Paulus and Armin Haeberle

>> Mr Van Riet, in 2007, Wienerberger had the best year in its history, followed by years of restructuring. In hindsight, what would you have done differently?

<< We couldn't have responded any other way than we did. We are in a strongly cyclical business. In the past, we've always balanced these fluctuations with our geographic portfolio. But the worldwide economic crisis caught us in a way that we couldn't have foreseen. Because of shattered consumer confidence, insecurity and restricted lending from banks, construction plunged around the world. This made a serious adjustment of our capacities necessary, along with restructuring measures.

>> Did you react too late?

<< No, we reacted very quickly and appropriately. In July 2008, we were the first to come out with a profit warning and the first to announce, as well as implement, the appropriate measures. We completed projects that had already been started but simultaneously mothballed or closed older sites. If anything, we did hesitate too long on our price reductions. That's why we lost market share at the beginning of the crisis, but regained it in 2009 and 2010 – and even partially expanded it.

>> In the past two years you reduced working capital by more than EUR 250 million. Isn't that a bit risky?

<< As part of the restructuring, we set ourselves the goal of limiting working capital to roughly 25 per cent of turnover. We feel comfortable with this level and believe that it leaves us enough room to manoeuvre. But we shouldn't go lower than that, indeed.

>> Can you actually respond to increases in demand?

<< We still have enough spare capacity. For 2011, we expect an average utilisation of 65 per cent of capacity; whereas 80 per cent would be ideal in terms of utilisation without having to expand capacity. And we still have roughly 20 sites mothballed that we could restart within three to four months. What we have to keep in mind is that the construction business is a very local one. There is no use in reactivating a site in Bulgaria when demand is rising in Hungary or southern Germany.

>> So there are no economies of scale...

<< We're trying to achieve that by ensuring that our local sites are bigger, in general, than those of our competitors. More importantly, though, is that with local production we avoid transport costs and, above all, currency risks.

"We've become much more careful"

Wienerberger has renegotiated their covenants, issued a EUR 100 million bond and is planning a share buyback. A good two years after a sweeping restructuring, CFO Willy Van Riet feels optimistic once again and can even laugh about Wienerberger's unsatisfactory rating.

>> How do you shelter against FX volatility, specifically in emerging Europe?

As we produce and sell locally, exchange rate risk is not really a problem. Strictly speaking, the money comes back to the group only once a year through dividends. Contrastingly, when it comes to cash management, we do keep centralised cash pools for each and every country that we are active in. These cash pools are formally located in and managed from Vienna, but are kept in local currencies. That way we optimise the cash management for every foreign subsidiary, while leveraging management synergies and minimising currency risks within the group.

>> You have recently placed a EUR 100 million bond. Why did you opt for a bond?

<< We currently have a base leverage of two times net debt to EBITDA. Our policy is to not have a ratio of more than 2.5 by the end of the year. We have been leveraged higher before, but as many other cyclical industries, we have learned to be much more careful when it comes to financing. Bonds make us less dependent on the banks and leave our credit lines untouched for other projects or acquisitions. And honestly, we also want to wait and see how the pricing of bank credit develops throughout the course of Basel III regulations.

>> But the volumes of your bonds consistently decreased since 2005.

<< In the past, we wanted to collect as much as possible from an issuance. The problem with this, however, is that when such a bond expires a huge sum needs to be refinanced all at once. And this is not always possible. For example, at the moment, capital markets are virtually closed. Therefore, we now prefer to place more, but smaller bonds to optimise our maturity structure and to diversify our financing portfolio.

>> At the beginning of 2011, you renegotiated your bank covenants. Why did it come to this?

<< Up until recently, our covenants were, amongst other things, based on EBIT ratios. But since we work in a sector that is very investment intense and has a high depreciation rate, we think that EBITDA is actually the better gauge. The banks have acquiesced in this interpretation and we now have only two very simple covenants: the net debt to operational EBITDA ratio is not to be larger than 3.5 and the EBITDA interest cover may not fall below 3.75.

Additionally, rather than every quarter, our covenants will be checked only every six months in the future, which also makes more sense due to the cyclicality of our business.

>> We now prefer to place more, but smaller bonds to optimise our maturity structure and to diversify our financing portfolio. <<

>> In 2008, Wienerberger still had an investment grade rating, but that is no longer the case. Do you feel like you're being fairly rated?

<< A company never feels fairly rated [laughs]. But now seriously: rating agencies have their methodologies; whether these are correct or not is not for me to judge. In any case, we were not the only one in our sector who was downgraded. We certainly want to return to investment grade, but not at all costs.

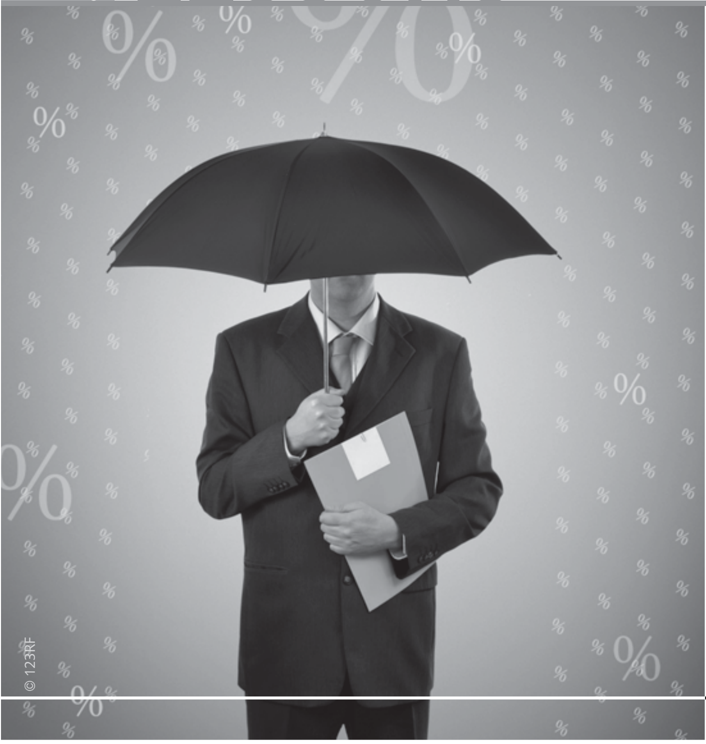
>> What do you mean by that?

<< We are first and foremost accountable to our shareholders and not to rating agencies. Obviously, we want to improve our results, which would also, in turn, positively influence our rating. But remember, we were able to place our latest bond and the one from 2009 without any problems on the market.

>> In your annual report, you said that there are no plans for a share buyback. Why did you change your mind?

<< We are planning to buy back 2 per cent of our stock, which makes complete sense given the current market-price. This allows us to create some wiggle room, for example, for potential acquisitions, although we currently have no concrete plans in that regard. ||

armin.haeberle@finance-ee.com



Corporate Securitization:

Seven Lessons for a CFO

Prof. Dr. Andre Thibeault
Dr. Dennis Vink

Before the subprime meltdown the asset-backed market had grown to become one of the largest capital markets in the world in terms of size and volume. The market was not only accessed by financial institutions, but also by corporates. Corporates increasingly often used securitization techniques to refinance whole lines of businesses by issuing asset-backed debt that was rated multiple notches above the rating of the parent company. One of these instruments that were used is whole-business securitization, also defined as operating-asset or corporate securitization. [1] The overall issuance has continued in Europe and the United States despite the crisis, albeit at lower levels. [2] An interesting example of a recent transaction done in the market is that of Church's Chicken.

In February 2011, Church's Chicken issued secured bonds in the aggregate principal amount of $245 million. The new credit facility is the first whole-business securitization completed in the restaurant sector since 2007. The bonds are backed by the franchise revenues of the nearly 1,450 franchised Church's Chicken-branded and Texas Chicken-branded restaurants in operation both domestically and internationally and substantially all of the tangible and intangible assets of the approximately 230 company-owned Church's Chicken-branded restaurants in operation in the United States. The new credit facility is the first whole-business securitization completed in the restaurant sector since 2007.

> "The performance of whole business securitizations backed by restaurant franchise payments, such as the Church's Chicken bond, has been «stable,» note Moody's Investors Service analysts. These haven't suffered during the economic downturn because they experienced «milder customer traffic declines than did the more expensive fine dining and casual dining industry segments,» the analysts note. [3]

1 In one year's time, both the Dunkin Brands transaction (May 2006) and the Domino's Pizza deal (April 2007) pushed about $3.5 billion of asset-backed papers onto the market.

2 See report "Recent Developments in Securitization", published by the European Central Bank in February 2011.

3 http://www.dowjones.de/site/2011/02/churchs-chicken-puts-franchise-fees-on-abs-menu.html.

The decision to use whole-business securitization involves an explicit choice regarding the financial structure concerned as well as managerial involvement and control. This article aims to introduce the reader to the structural features of whole-business securitization by discussing 7 important lessons.

First, the general concept of asset-backed securitization will be discussed. Next, the reader will be introduced to the terminology framework for whole-business securitization. Finally, an answer will be presented to the question how whole- business securitization distinguishes itself from more traditional areas of corporate finance.

Lesson 1:

The definition of asset-backed securitization refers to the issuance of tradable debt papers, which are guaranteed based on a well-defined collection of assets.
Unfortunately, the term 'asset-backed securitization' is used differently by many, and the usage is not necessarily comparable. Asset-backed securitization first appeared in bank funding. Hess and Smith (1988), for example, defined asset-backed securitization as a financial intermediation process, which re-bundles individual principal and interest payments of existing loans to create new securities. More recently, the term 'asset-backed securitization' has come to be used to refer to so-called 'structured finance', the general process by which illiquid assets are pooled, repackaged and sold to investors. So, asset-backed securitization can best be defined as the process in which assets are refinanced in the capital market by issuing securities sold to investors by a bankruptcy-remote special purpose vehicle. This definition comprises the fundamentals of asset securitization.

Lesson 2:

The objective is that only the investors in the SPV will have a claim against the securitized assets in the event of the seller's bankruptcy: not the seller or the seller's creditors.
Legal concepts in the area of securitization often differ, and thus have specific accounting and tax rules, including tax consequences for both sellers and investors. Common-law countries (such as Australia, the United Kingdom and the United States) for example, follow different legal rules in comparison with civil countries (most other countries). Despite fundamental differences in the legal environment, the primary objective of the SPV is to facilitate the securitization of the assets and to ensure that the SPV is established for bankruptcy purposes as a legal entity separate from the seller. In other words, the objective is that only the investors in the SPV will have a claim against the securitized assets in the event of the seller's bankruptcy: not the seller or the seller's creditors. Because the pool of assets is insulated from the operating risk of the seller, the SPV in itself may achieve better financing terms than the seller would have received on the basis of his own merits. This is the key driver for reducing financing costs by securitization in comparison with alternative forms of financing.

Lesson 3:

Asset-backed securities are not the same as covered bonds.
The objective of securitization is that the investors in the SPV will have a claim against the securitized assets in the event of the seller's bankruptcy: investors do not have recourse on the seller. That makes securitization different than covered bonds, because covered bonds do not allow for risk transfer in the same way as securitized products. In the event of default, asset-backed securities have recourse only on the pre-defined pool of assets in the SPV, while covered bonds have recourse on both the SPV and the seller of the assets. So one distinct feature from securitized products is the liability of the seller in the event of default. Note that covered bonds are frequently used as an alternative for residential mortgage-backed securities (RMBS).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Prof. Dr. Andre Thibeault

Professor of Finance and Risk Management

Academic Director at Vlerick Center for Financial Services

Lesson 4:

The element of future exploitation of the asset is a key distinction between standard securitization and whole-business securitization.
Whole-business securitization uses securitization techniques for refinancing a whole business or operating assets. You may wonder what exactly is meant by 'whole business', and where precisely the difference lies compared with the


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Dr. Dennis Vink

Associate Professor of Finance

Director at Nyenrode Center for Finance

more usual types of collateral used in securitization transactions: credit cards or mortgages, for example. In order to make you understand whole-business securitization, its definition will be presented first. Next, the difference will briefly be explained between whole-business securitization and the more common forms of securitization, as we know them today: for example the use of mortgages and credit cards. Whole-business securitization can be defined as a form of asset-backed financing in which operating assets are financed in the bond market via a bankruptcy-remote vehicle (hereafter: SPV) and in which the operating company keeps complete control over the assets securitized. In case of default, control is handed over to the security trustee for the benefit of the note holders for the remaining term of financing. One of the great challenges lies in defining the difference between operating asset securitization and the more common forms of securitization transactions. Consider for instance a mortgage pool. If the mortgages have been securitized, the seller (sponsor) has no further obligations towards the consumer. The mortgage has been closed and stipulations concerning future payments – to be made by the consumer – have been laid down in a contract. Simply stated, the financial institution then collects payments from the consumer for the balance of the life of the loan. In effect, the traditional classes of securitization assets are self-liquidating. By contrast, in the example in which claims on the basis of operating assets are securitized, the sponsor has an obligation to exploit the underlying assets. To offer an illustration: when a football club securitizes its revenues from the sale of tickets, the sponsor must continue to render services that allow football fans to buy their tickets at the box office. Thus, the securitization process requires permanent managerial involvement on the part of the original owner in order to generate revenues. The element of future exploitation of the asset is a key distinction between standard securitization and operating-asset securitization. Control over the cash flows of the securitized business is established either through a sale of the assets, or through an adequate legal structure that ensures continuation of cash flows in the event of the insolvency of the borrower. [4]

Lesson 5:

The receiver has authorization to seize control over the assets of the securitized business at the loss of any other creditor.

In a standard 'whole-business securitization' transaction, a financial institution grants the sponsor (or originator) a loan secured by a pledge on the assets. This secured loan is then transferred to a bankruptcy-remote special purpose vehicle, which issues the notes. The security attached to the loan is also transferred to

5 This feature makes it difficult in some countries to structure a business securitization deal. In fact, it has been proven to be hard to separate the assets legally while the sponsor still retains operating control and services these assets. Under U.K. law, this difficulty has almost been eliminated by the 1986 Insolvency Act, which permits the holder of a charge over substantially all of the assets of a corporate to control the insolvency proceeds of that corporate through an administrative receiver.

the SPV. Thus, ownership and control of the assets remain with the sponsor, and bondholders are only granted charge over those assets. Control is required because the owner of the assets should exploit the assets for the full term of financing. Also, the sponsor intends to repay the loan out of the cash flows generated from its business. In case of default of the sponsor, the SPV receives complete control over the securitized assets by appointing a receiver for the full term of financing. The receiver has authorization to seize control over the assets of the securitized business at the loss of any other creditor. This is called bankruptcy remoteness. The SPV increases the likelihood of the business being able to continue as a going concern rather than being forced to have a 'fire sale" of the individual assets. This preserves the value of the assets securitized, which is of great importance to the investors. Whole-business securitization therefore efficiently uses the privileges of bankruptcy law offering bondholders extensive security in case of default.

A clear case of effective receivership in default is that presented by Welcome Break, the U.K.-based motorway service area operator and the first whole-business securitization operation in its segment. When Welcome Break was no longer able to meet its obligations following its weaker-than-expected operating performance in 2002, the owner was in danger - if the economy continued to slide – of landing in a situation in which the company would not be able to meet its debt obligations. The owner then made an offer to the bondholders: Class A's were to be repaid at par (£309 million par value), and Class B's at 55% (£67 million par value). The bondholders rejected this proposal. Subsequently, after Welcome Break failed to make full payment on its loan, it was put into receivership. Deloitte was appointed administrative receiver. A few days later, the owner and the administrative receiver finally organized a solution; the owner agreed to pay all classes of bondholders back at par by selling nine service stations.

Lesson 6:

A whole-business securitization structure tends to carry a lower average cost of debt compared to ordinary debt, and it usually issues debt with a longer maturity, which reduces pressure on the corporate issuer to place refinancing.

The result of bankruptcy remoteness is that the SPV generally issues securities that are rated higher (and in many cases significantly higher) in comparison with other alternatives, such as the issuance of ordinary secured debt by the company. This is the result of the risk mitigation generated by isolating the assets from the bankruptcy and other risks of the parent company through the whole-business securitization structure. Hence, the holder of an asset-backed bond is in a position similar to that held by the holder of an ordinary secured bond with regard to the sponsor, because repayment of the bonds takes place from a defined pool of assets. The difference is that the holder of an asset-backed bond is not affected by the non-performance of the sponsor's other assets, whereas the ordinary bondholder is.

Furthermore, structural features in whole-business securitization are designed to decrease the moral hazard of the borrower, and to decrease potential investment conflicts between borrower and bondholder. In other words, these features mitigate the risk that the strength of the business will be impaired through mismanagement. Also, the structure is secured by the entire set of cash flows generated by the assets, as well as the value of the underlying assets. As a result, the structure tends to carry an average lower cost of debt in comparison with ordinary secured debt, thanks to restrictive covenants on both the asset and liability side of the company. It usually issues debt with a longer maturity, which reduces pressure on the corporate issuer to place refinancing.

Lesson 7:

Post-meltdown whole business securitizations are similar to the whole business deals that were closed prior to the meltdown, but….

The credit crisis had revealed several shortcomings in the securitization

structure that includes: lack of transparency regarding collateral, failing monoline insurance companies, and the recognition that financial engineering cannot offset the risk related to the fundamentals of the operational business . Although we expect post-meltdown whole business securitizations to be similar to the whole business deals that were closed prior to the meltdown, we expect investors to favor simple and transparent structures so that investors can now scrutinize the product more carefully. Without a doubt less financial engineering is possible since we know now that credit enhancement by monoline insurers is not very popular among investors these days. That would probably result in less triple-A rated tranches in the structure. Tranches would reflect their real risk according to the cash flow waterfall and subordination levels. Also, originators are expected to have more skin in the game that requires them to retain some of the junior tranches in the structure.

Conclusions

Whole-business securitization enables a business to set up a structure in which business and financial risks can be managed and in which the level of credit risk for the investor can be substantially reduced. It could be a good alternative as opposed to a more traditional secured loan or collateralized mortgage-backed securities (CMBS), because of the limited amount of debt capacity available to companies.

Corporate securitizations have primarily focused on the intellectual property arena, including fast food, licensing, music, film and drug royalties. But certain kinds of businesses are not likely to benefit from a business securitization transaction. These include businesses that are capital intensive, are reliant on unique management skills, or are evolving rapidly. All of the business securitization transactions executed were business activities of which the cash flows could be accurately estimated thanks to long-term contracts and a well-documented history of stable cash flows through which the business and financial risks were considered low, or could be significantly mitigated by structural features.

Applying such structures, however, is not without risks: witness the problems encountered in the Welcome Break transaction. A combination of too little return on investment and too high leverage damaged the sponsor to such an extent that it was ultimately forced to make repayments to the investors by winding up the business.

The euro's existential challenge

Dr. Bruno Colmant

The euro marks the end of the welfare state and budgetary indiscipline.

In 1999, after twenty years of currency crises, the fluctuation bands between several European currencies were tightened so that they could be merged into a common currency. The euro was born. At that time, the Member States were initiating a Bretton Woods-type European agreement, this time dissociated from gold parity. They abandoned the guardianship of their own currencies and deprived themselves of their regal right to mint coins. Immediately, we saw a convergence of interest rates, an end to competitive devaluations and facilitation of trade within the Community.

However, economists who understood the consequences that such a choice would bring about were rare. The euro was, and still is, based on the premise of the mobility of factors of production. Indeed, from the moment when states are constrained by a common currency without the ability to devalue or revalue their national currency, it becomes the role of the factors of production, i.e. people and capital, to become more flexible, moving back and forth between labour markets and areas of growth.

This evidence is confirmed by the theory of optimum currency areas, introduced in 1961 by Robert Mundell, recipient of the Nobel Prize in Economics in 1999. Mundell suggested that it is in countries' interests to form a currency union if the mobility of the factors of production (work and capital) inside the area concerned is greater than that which predominates outside of it. If the opposite case is true, it is in the interest of the countries concerned to maintain flexible exchange rates.

This is why the euro is not yet an accomplished fact. The factors of desynchronization are many: antagonistic geographies and growth models, the absence of a federal European tax system and budget, inconsistent access to financial markets, social system disparities, diverse pension systems, contradictory inflationary pressures, demographic differences, a lack of synchronization of economic cycles, etc.

We have thus arrived at a singular contradiction – the combination of a common currency and the financial crisis. We might have imagined that following the creation of a currency union, the financial sector and the labour market would grow less tense. But we have seen just the opposite: after the bank crisis and the financial demands of the states, the financial sector has been put back into the public sphere whilst the rate of labour mobility has remained very low.

We may moreover wonder if the euro, which constitutes a decisive choice based on the market economy, does not present a deep contradiction with the growing influence of a majority of European states in their own economies. If any doubt about this reality exists, one needs only to note that today, it is the financial markets that impose sanctions on states that are unable to keep their budgets in line. How is it possible to claim reserve currency status in a continent whose bank systems are under near-public guardianship? This is all the more true since public debts are so high that rescinding them would inevitably mean currency depreciation, i.e. inflation.

In the labour market, the situation is much more serious. Europe is threatened with endemic and structural unemployment, linked especially to the lack of integration of young people into the workforce, the absence of retraining incentives, the massive drain of industrial employment, etc.

But there is more gloom ahead: the mobility of capital forces social and educational systems to compete against each other, leading to their convergence. Over the next decade, workers will have to become extremely adaptable so that their mobility reflects the choices of monetary harmonization. At the same time, we should not delude ourselves. Proposing labour mobility is easy to do, but putting it into practice should not be an end in itself unless we accept that the euro is part of a market economy practice to which it contributes. Even at this stage, there are inescapable realities to contend with, such as the lack of linguistic, cultural, institutional, and legal unity.

In order for the common currency to succeed, two problems must be resolved, each one connected to the all-important mobility of factors of production. With regard to capital, the States will have to loosen their grips on the financial system, which will inevitably necessitate a decrease in the public debt.

With regard to labour, workers' international mobility will have to be made more flexible and fluid, at the cost of more restrained social protection. If these two problems cannot be resolved simultaneously, the result will inevitably be a risk of monetary breakup, accompanied by national tensions which, as is already the case in Greece, Ireland and Portugal, endanger the homogeneity of the common currency. This being the case, if a country seceded from the eurozone, it would lead to some very contradictory effects. The errant country would set off a spate of monetary contamination and an importation of inflation. Conversely, this act would reinforce the economies at the heart of the continent – the euro would strengthen and its competitiveness would fall – but with a good deal of uneasiness in their banking systems. All countries would thus have something to lose in the event of a monetary breakdown. Instead of leaving the eurozone, those countries that have been weakened will restructure their public debt by appealing to their national financial sectors.

Dr. Bruno Colmant

Professor at UCL and Vlerick Management School

Member of the Royal Academy of Belgium

In conclusion, the choice of a common currency was an excellent one, but the durability of the eurozone is not an established fact. The socioeconomic models of the Member States cannot simply be stowaways on board a monetary godsend. The euro is a part of the demanding market economy. It carries within itself an adjustment of our social protection systems in the direction of more competitiveness and flexibility.

What is worse, the euro is effectively confirming the end of both the welfare state and budgetary indiscipline. And when certain nostalgists lament the social model of post-war Rhine capitalism, they have good reason to do so. The new economic directives will definitely come from across the Rhine – but from Frankfurt rather than Berlin! The European Central Bank will be the one to determine, more than ever, the social and competitive model for the continent to follow. The euro therefore carries within itself an adjustment of our social protection systems, calling for more competitiveness and flexibility.

More, please

ALEXANDRA GROPP AND **DOMINIC KERR** LOOK AT WHY DIM SUM BONDS HAVE WHETTED THE APPETITE OF BORROWERS AND INVESTORS, AND EXPLAIN HOW THE MARKET OPERATES.

The offshore renminbi bond market, or the dim sum market as it has become widely known, has been growing rapidly since 2007 – the year the Chinese authorities first gave their blessing to banks in the country raising funding in this market. First banks in mainland China and Hong Kong accessed the market, followed by local/regional corporates.

Dim sum bonds have been on the radar of Western corporate treasurers for a little over a year now, ever since US fast food giant McDonalds tapped this market in August 2010. McDonalds has since been followed by a number of other US and Western European corporates, with Unilever the first European corporate to issue a dim sum bond, a CNH300m deal in March of this year. (CNH is the same currency – renminbi – as CNY, but is traded offshore at a different rate from mainland-traded CNY.)

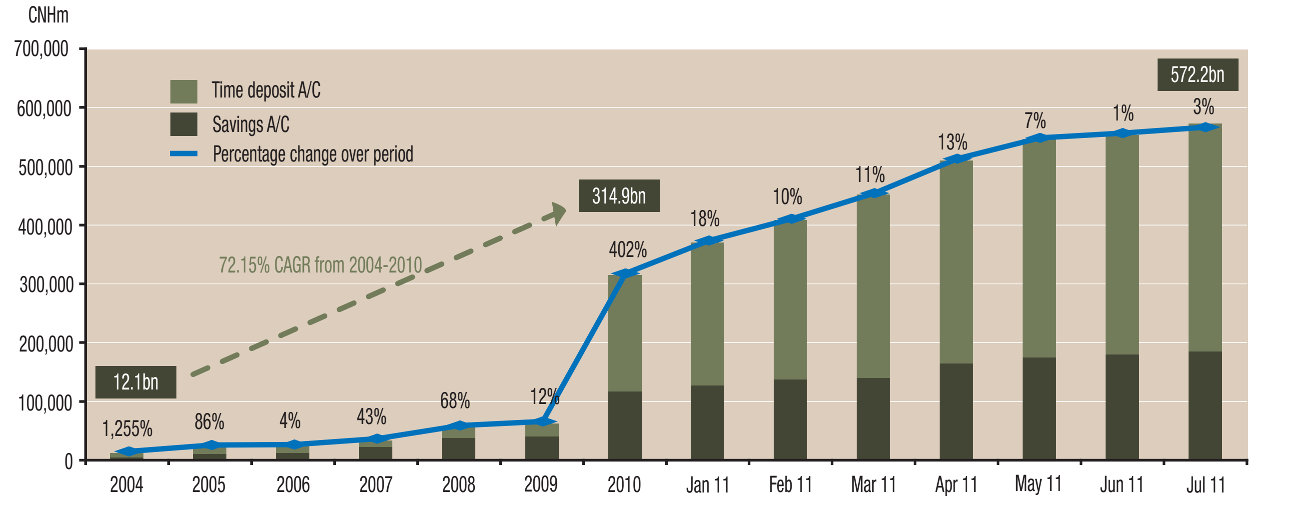
With the number of Western corporate issues now in double figures, and a sizeable pipeline of similar borrowers eyeing up this market, it's a good time to take stock of what has been achieved and to analyse why these borrowers have been attracted by the new marketplace.

CHASING THE CHINESE DREAM The sheer potential of the Chinese marketplace for Western corporates means that any window that opens up for them to gain greater access to financing there merits serious consideration. The appeal of reaching out to China's burgeoning middle class is a particular draw for consumer and retail sector companies, and these have been prominent among the early entrants to the dim sum market. Some of these companies have been growing their businesses in mainland China for many years, and have firmly established brands, material assets and large numbers of employees. What could be more natural than to take advantage of a partial liberalisation of the market to raise CNH offshore, and to take these proceeds onshore into mainland China for deployment in their operations there?

In relation to its dim sum bond, Tesco's chief financial officer, Laurie McIlwee, says: "China is an important market for us and represents a great growth opportunity. This is a new and innovative way of funding our business as it continues to grow and demonstrates our commitment to China."

RAISE OFFSHORE, TAKE ONSHORE Hong Kong has been the laboratory for this stage of China's CNY liberalisation/ internationalisation experiment. Dim sum deals are co-ordinated, syndicated and distributed out of Hong Kong, a jurisdiction with which Western corporates are very comfortable. Typically documented under English law (or New York law in the case of US issuers), these deals can be issued either off a Euro Medium Term Note (EMTN) programme or via standalone documentation. The whole process of documenting and issuing a dim sum bond will be very familiar to any treasurer who has done a public bond in any of the G3 currencies (the dollar, the euro and the yen).

Figure 1: CNH deposit base



Source: HKMA

If a roadshow is necessary, this will take place in Hong Kong and Singapore. The dim sum market therefore offers the possibility of raising renminbi without having to go physically to mainland China along with the comfort of "home-town" legal code and familiar documentation, all with English as the lingua franca. As dim sum is an offshore market, by definition none of the investors will be in mainland China.

The actual execution of a dim sum bond is then at least as straightforward as issuing a sterling, euro or dollar bond. It could be argued that as issue sizes are normally smaller than in the G3 currencies, and the investor base more compact, the dim sum issue process can be even quicker and more straightforward.

Most corporates that issue dim sum bonds intend to use the proceeds within mainland China, but there are some exceptions. If a potential borrower were, for example, to have a Hong Kong-based supplier that accepted payment in renminbi, that would be an almost perfect scenario; there would be no need to go through the processes required to take the proceeds onshore into mainland China (as described below).

However, in the great majority of cases the intent is to fund operations or pay suppliers in mainland China. So what are the drivers for going through the onshore approval process?

THE ECONOMIC IMPERATIVE The dim sum bond market enables corporates to capitalise on the very different onshore and offshore borrowing rates for CNY and CNH. Onshore renminbi (ie. CNY) borrowing rates are regulated by the People's Bank of China (PBOC) and are currently set at the following minimum levels:

- one year, 6.56%;
- three years, 6.65%; and
- five years, 6.90%.

The rigidity of this regulated system means that even the best-rated corporates are unable to take full advantage of their credit quality in achieving a superior rate of borrowing compared with their lower-rated peers.

In comparison, the dim sum market has no such regulation and is able to set its own market-driven levels for borrowing. The coupons paid by the majority of Western corporates in this market to date are 1–3%. The saving for those corporate borrowers able and willing to go down the dim sum route and then onshore the proceeds are very significant.

Any corporate that is borrowing (or contemplating borrowing) within mainland China at the regulated onshore rates should therefore be asking itself if the dim sum bond market bears serious consideration as a real alternative. With the fulcrum of investor demand still in the two- to three-year range, this is not a long-term bond market in the traditional sense. However, there is still the opportunity for a superior economic outcome when compared to the pricing of onshore loans.

For borrowers looking for longer-term instruments, the outlook is positive. While for the foreseeable future investor demand will continue to be anchored in the two- to three-year range by private banks and fund managers, the maturity curve is gradually lengthening, with the Chinese Ministry of Finance's own 10-year dim sum deal, and the seven-year tranche for French corporate Air Liquide (see below) two signposts in that direction.

OTHER DRIVERS The dim sum bond market is an initiative that the Chinese authorities are keen to promote. There will be cases where obtaining their approval to onshore funds will be much harder to get (eg. residential or commercial property development/purchase, consumer finance). However, where the borrower's goal is to inject funds that will promote real economic activity, economic expansion, jobs growth and technology development, our experience is that a very constructive attitude will be taken towards applications to onshore dim sum proceeds.

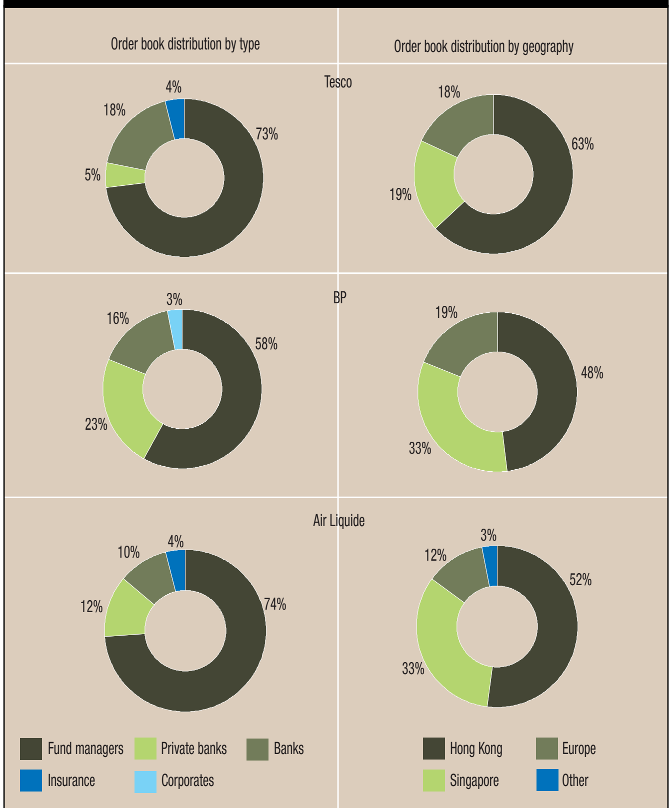
In every case we would recommend that all the necessary approvals to onshore are obtained prior to the execution of a bond issue. This avoids the risk of having renminbi funds "trapped" in Hong Kong and incurring a cost of carry on deposit; it also ensures that positive relations are maintained with the Chinese authorities. The commitment to the mainland China market reflected by issuing a dim sum bond and taking bonds onshore is a big positive for long-term investors in this jurisdiction.

The investor diversification achieved in issuing a dim sum bond gives borrowers profile in a region where there is a very substantial amount of capital available for investment. We have already seen several Western corporate borrowers take volumes from the market in a single deal that are equivalent to dollar or euro benchmarks in size – ie. $500m.

For borrowers with assets and revenues in mainland China, raising a dim sum bond is likely to be the most economic natural hedge available. Corporate treasurers should realise that the optimal solution for mainland China funding is freely available to them via this market.

IT'S A STRATEGIC PLAY, NOT AN ARBITRAGE MARKET It is important to make the point that at this stage of its development the dim sum market is not an arbitrage market in the way that the markets for Swiss francs and Australian or Canadian dollars are sometimes viewed. While liquidity in the renminbi swap market is improving, especially in the one- to three-year range, it is still relatively poor and the "wrong way round" axe out of renminbi means that raising a dim sum bond and trying to swap the proceeds

Figure 2: Order book distribution



Source: HSBC and SCB

back to euros, dollars or sterling will typically not result in a positive economic outcome. The decision to issue a dim sum bond is therefore a strategic one, although given the tenors available in the current market (typically one to three years) it is a decision which is more comparable with the loan market.

INCREASING APPETITE FOR DIM SUM CNH bond issues from multinational corporates are still a relatively small part of the dim sum bond market but they have significantly raised its profile and played an important part in increasing and diversifying the CNH investor base. The growing volume of the CNH deposit base and the anticipated appreciation of CNH continue to fuel the strong demand for dim sum bonds. As of the end of July, the CNH deposit base in Hong Kong stood at CNH554bn, compared with approximately CNH145bn bonds outstanding. This imbalance has acted to lower offshore deposit rates, consistently in the 1-2% region.

Given the wider market volatility in recent months, price discovery and transaction timing were paramount for the success of the recent transactions. Liquidity in the secondary market is still developing due to the nascent nature of this market. In particular, the smaller-sized transactions from highly rated borrowers are tightly held and not traded frequently. This has driven secondary market prices higher and yields to levels that cannot serve as meaningful pricing benchmarks for new primary issuances. Direct feedback from investors on pricing therefore remains key.

Tesco initiated another wave of debut CNH bond issues from multinational corporates in late August with a three-year CNH725m transaction. Its household name and credit strength attracted strong investor interest. BP followed shortly thereafter with its successful debut CNH700m transaction.

And the day after the BP transaction priced, Air Liquide issued CNH2.6bn across five and seven-year tranches, a record for a non-Asian CNH issuer. Air Liquide had undertaken an investor roadshow in August to gauge interest and then waited for more stable market conditions before launching the transaction. Although most investors continue to prefer shorter maturities from three to five years, longer tenors are possible, as demonstrated by Air Liquide's privately placed seven-year tranche.

Investors based in Hong Kong and Singapore continue to drive the demand for CNH transactions but we have seen solid demand from European investors and expect it to grow further as more accounts put the necessary infrastructure in place. All CNH bond offerings so far have been sold under Regulation S, which restricts marketing activities to accounts outside the US. US investors with funds based offshore have been involved in some transactions but when decision-makers are based in the US, the time difference continues to be a challenge for transactions where order books open and close intraday during Asian business hours.

All the recent bonds were listed at a stock exchange in either Hong Kong, London or Luxembourg and had at least one credit rating, which is preferred by some key investors in the CNH market and supports best possible execution, especially for larger transactions. Although not necessarily required for household names, some form of investor marketing can be very beneficial as a lot of the Asian investors do not look at European credits on a regular basis. For less well-known names we believe it is essential that investors are given the time and information required to complete their credit work.

With regard to the final BP order book, Gary Admans, its head of capital markets, said: "The CNH bond market offers a good opportunity to gradually add diversification to our investor base and fund our businesses in China at an attractive rate. We were very pleased to see strong interest from accounts in Hong Kong, Singapore and Europe. Pricing the transaction at 1.7%, the tight end of final guidance, was a success considering the volatility in the global markets."

REMITTANCE APPROVAL PROCESS The CNH bond market offers companies a very attractive opportunity to fund their mainland operations. While CNH bonds can be used to finance trade settlement or be swapped to other currencies, to date all but one multinational corporate have used the proceeds to fund their mainland operations in China. Remitting the issuance proceeds to mainland China requires approval from the Chinese regulators, so obtaining these approvals is a very important part of the transaction and often the most time-consuming.

The remittance approval process is independent from the CNH bond issuance in Hong Kong, which in itself does not require any approvals from the Chinese regulators. It is recommended to start the bond documentation and the remittance approval processes in parallel to ensure the market can be tapped as soon as all necessary approvals have been received.

Funds can be remitted to mainland China by way of a loan or an equity capital injection from the offshore parent or a related company. So far most companies have chosen to remit issuance proceeds to mainland China via a shareholder loan, which requires the approvals from two regulatory bodies, PBOC and the State Administration of Foreign Exchange (SAFE). Such a loan has the advantage that its terms can be tailored to match the debt service on the CNH bond. An equity capital injection does not allow the same flexibility given that cashflows from mainland operations can be extracted only in the form of dividends, which makes the management of payment of interest and principal on the CNH bond more complex. Equity injections require the approval from Ministry of Commerce.

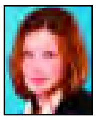
One disadvantage of a shareholder loan is that its amount – and therefore the money that can be remitted to mainland China – is restricted. The available limit, also called "gap" or "foreign debt quota", is defined as the approved total investment of the receiving entity minus its registered capital. This restriction applies to all shareholder loans and is not specific to the funds raised in the CNH bond market.

This might change, however. In early August, China's regulatory authorities indicated that the remittance of CNH bond proceeds via renminbi-denominated shareholder loans might no longer be subject to the foreign currency debt quota. This could significantly reduce the restrictions on the amount of funds that can be remitted to mainland China. In our view, this would contradict the policy-makers' hitherto firm grip on the amount of CNH bond proceeds that can flow to mainland China. We expect this to be clarified in a new set of guidelines for the remittance approval process which we believe will be issued in the near future.

DIM SUM IS HERE TO STAY China's regulatory authorities are committed to developing the offshore CNH market as part of the internationalisation of the renminbi. Regulations and conditions for the remittance of CNH bond funds to mainland China will continue to develop. Banks with a strong local presence, a detailed understanding of the processes and strong relationships with the local regulators are best placed to guide issuers through the sometimes complex challenges of seeking all necessary approvals for bringing funds onshore.

Fabienne Lecorvaisier, group chief financial officer for Air Liquide, says of the overall process: "One of the more challenging aspects of completing the transaction turned out to be securing the regulatory approvals from PBOC and SAFE for the remittance of the proceeds onshore. The Chinese regulators are understandably careful to make sure the funds are not simply hot money but represent investments which are important to the economy. There were numerous other applicants also competing for approvals from the regulators, which can cause something of a delay in the process."

Note: The Chinese authorities published revised guidelines for foreign currency remittance as this article went to press.



Alexandra Gropp is director, debt capital markets, at Standard Chartered Bank.
Alexandra.Gropp@sc.com
www.sc.com

Dominic Kerr is managing director and European head of corporate origination, at HSBC.
dominic.p.kerr@hsbcgroup.com
www.hsbcgroup.com

Germany, Article: State Over-Indebtedness Endangering the Euro, How we Got Here, and How to Regain Stability

by Helmut Schnabel, Chairman of the Board,
Association of Chief Financial Officers Germany

Also 3 years after the Lehman bankruptcy the financial markets are in an ongoing crisis.

Some cisis areas are moving towards a solution, other crisis areas continue to exacerbate.

Through the necessary bailouts of banks in 2008 , the state indebtedness in the USA, in many European countries, and also in Germany, has increased beyond an acceptable volume. Especially in Europe, several countries, including Germany, have left the Euro Treaty Maastricht Criteria of government debt of maximum 60 % of GDP far behind themselves. Already, France and Germany are at over 80 %. The USA have arrived at 100 %.

Adding to this, is the much more dramatic over-indebtedness of Greece, 158 % of GDP, of Ireland, 114 % of GDP, and of Portugal, 106 % of GDP.

The bailout measures for these three countries are known, and for Greece they continue to ever increase.

The deficiencies of the construction of the Euro, known from the beginning, are becoming ever more evident and are demanding an ever increasing tribute.

Nevertheless, it is unforgotten, what politics has promised to the people, when introducing the Euro:

It will be as hard as the Deutsche Mark.

The European Central Bank will be as independent from politics as the German Central Bank, the Bundesbank, and it will have the maintenance of price stability as its one only objective.

The European Treaty on Stability and Growth will largely contain the negative effects of a still missing uniform European Fiscal Policy.

And finally: Euroland is not a transfer union, but it is a stability union.

Today, we know, the reality is a different one:

1) Our own politicians are breaching the European Maastricht Treaty. According to article 123, every country is liable for its own debt only. Instead, huge bailout umbrellas have been erected for the known over- indebted states. A kind of state-internal financial equalisation transfer between provinces is being done, from the still financially stable states to the financially unstable and over-indebted states.

Bad debts of the receiving states are financed with new, and temporarily still better, debt of the donating states, which themselves move towards an overextended indebtedness.

The system as a whole increases the indebtedness.

We have already arrived in the first chapters of a transfer union, without that the people were ever allowed to have a popular vote on it.

In the meantime, the financial stability and the prime creditworthiness of the donating states is at stake. Buzzword France.

And 2) The European Central Bank also breaches the Treaties. It has not the duty, and not the right, to buy government bonds of highly indebted states in the secondary and primary market and quasi print new money for the state financing. And in spite of this, it is buying, in the meantime, even Italian and Spanish government bonds, with the declared objective, to bring down the bond issuing interest rate return and burden for these countries from 6 % to 5 %. Because, it is said, the 6 % interest burden is not tolerable.

However, and effectively, rising bond issuing interest rate returns and burdens, for over-indebted states, are the most effective, and politics independent, and market economy, means, to permanently install state budget discipline at these countries.

It has been forgotten, that Italy, with a comparable state indebtedness like today, in the 90ies, has paid interest rates of between 8 and 14 % on its government debt, and effectively shouldered this burden, without complaining about it. Then began, in the mid nineties, the European interest rate convergence speculation with regard to Italy, towards lower interest rates. In 1996, the Italian government bond prices were shooting up by over 30 %. Together with the interest coupon, the annual performance was 40 %, more than at equity investments. The bond issuing interest rate return and burden for Italy sank to 8 %, then 6 %, then 5 %.

And today, it is said, 6 % are not tolerable ?

If we forget the history, then we have lost, like the European Central Bank, the measures.

And 3) At the beginning of the Euro, Italy was allowed, and similarly so Belgium, to significantly exceed the Maastricht criteria of maximum 60 % state indebtedness related to GDP. Italy came in with even 105 % state indebtedness, promised to decrease it, but did not hold the promise.With fluctuations, Italy even further increased the state indebtedness up to today 120 %.

Here two different measures are applied. No hint of a stability union. And Italy is not even considering to move long term towards the direction of 60 % state indebtedness in relation to GDP, like the signed treaty says.

How shall such largely unequals, ever grow together to a stable union ?

Why should apply, to such largely unequals, in spite of this, almost the same interest rates levels ? How can central bankers say, that this is even desirable ?

Why totally different economics shall apply to states, compared to a free market economy ?

Politics is not giving clear answers.

Everybody is talking about the lately announced 50 % debt haircut for Greece. When looking at it more closely, however, the 50 % relate only to the 200 billion Euros Greek government debt held by banks in the world. Next to it exist almost as many other Greek government debts, which are held by other investors and by the European Central Bank.

Therefore, the announced haircut of Greek government debt is closer to 25 % only.

And for this reason, it is said, that the Greek government debt in % of the GDP will from presently 158 % , and only by 2020, decrease to still too high 120 % of GDP, that is on the Italian level, which markets have just about begun, to again sanction with higher interest rate burdens of 6 to 7 % for 10 year government bonds.

It has been publicly communicated, that the problems of Greece are much more severe, and more deeply rooted, and of a structural nature, and that therefore they cannot be resolved alone with these number plans. The probability of an even higher debt hair cut, and of an exit from the Euro, has further increased.

Whether the bailout umbrella EFSF, leveraged up to 1 trillion Euros, shall function, is stil open.

The special purpose vehicle EFSF, standing alone outside the government budgets and balance sheets, and this 4 times leveraged, is quite the kind of technique, which in 2008 got Lehmen Brothers and other banks into difficulties.

Markets and the public have realised, that not also additionally the 1.900 billion Euros of Italian government debt can be shouldered by a bailout umbrella. The remaining donating countries will not be able to shoulder such a big bailout umbrella, neither financially, nor economically, nor politically with a view to their domestic voters.

The consequences of the situation are known:

Through the debt haircut of Greece, the European banks must now be recapitalised with 107 billion Euros, to be executed until mid 2012. Will investors, and which investors, provide the money infusion ?

Already since long, the banks are reducing risky businesses and are shrinking their balance sheets. This will continue for quite a while.

According to the time table of Basel 3, the banks will have to further increase their equity base over several more years to come.

Since a few weeks, several large banks have voiced publicly, that they want to totally withdraw from investments in government bonds. This is new pressure on the states, to stop the continued increase of state indebtedness.

What so far has been regarded as totally risk free investments, that is government debt, also by way of regulations, in the own interest of the states, and what therefore had not to be underlied, partially, with equity in the banks` balance sheets, is now regarded by ever more banks as so risky, that they not now allocate voluntarily own equity as risk offset against it, but that they now want to totally withdraw from the investment.

Examples for this are Commerzbank, Royal Bank of Scotland, and to a lesser degree also Deutsche Bank. As said, examples only. The list is longer.

This is a real change in paradigm.

Insurance companies and pension funds must have similar thoughts like the banks.

Uniqa, one of the largest insurance companies in Austria, has just published a quarterly report with a high loss, and where the forecast loss for the whole year of 2011 has exclusively been caused by Greek investments.

Let us prepare ourselves for that the turbulences of the state financing and of the bank financing will continue for quite a while.

Since long, the real economy had to adapt itself to this situation. Who has enough earnings power has since long built up a liquidity cushion, which exceeds all measures of experience, of necessities, from the past decades.

That the reinvestment interest rate of the liquidity is lower than the refinancing interest rate, is being accepted, and is viewed as an insurance premium, and is being digested in the profit and loss statement, as a few days ago voiced the CFO of Bayer in an interview.

Also more unused credit lines with committment fees are being maintained than ever before in the past decades, so as well, as an example, by Bayer.

Other examples in Germany are BMW, Volkswagen, Robert Bosch, Siemens, to just name a few.

This is the situation of the real economy in Germany, in large parts of Europe, as well as in the USA.

A second large trend in the financing of the real economy is continuing: The external financing through banks is decreasing year after year, the external financing directly through the capital market is increasing year after year.

This is the trend for corporations with access to the capital market, and also for corporations with potential but so far unused access to the capital market.

The USA are much advanced with this trend, Europe has started visibly to move along this trend.

From 1999 to 2010, the portion of capital market financing through issuance of securities has increased in the real economy of the USA from roundabout 70 % to roundabout 80 %.

In Europe from roundabout 15 % to still roundabout 30 %.

And so, Standard & Poor`s is not surprisingly concluding, that bank loans becoming more expensive through Basel 3 and other measures with similar effects, will hit the non financial corporations financing much more negatively in Europe than in the USA. Let us position ourselves for this.

Fortunately, the situation for the European industy and its finances is good. According to Standard & Poor`s the ratings upgrades of industrial corporations in Europa since four quarters are roundabout twice as high as the downgrades.

And where the number of downgrades moves along a counter cyclical low, at less than a quarter of the number during the last recession 2008/ 2009.

The Europea state debt crises and bank crises are overextending us now for the second year in a row.

They divide our institutions, our political parties, our industry associations.

From each side, almost daily come up famous people with statements for the bailout measures, and against the bailout measures.

The media, by the majority, are well explaining the situation.

And nevertheles, there is the threat of the creation of legends. A failure of the Euro is said to be the end of Europe.

This produces taboos, and bans against independent thinking. And there is also the terrible words “ there is no alternative “.

What is true:

Europe has already survived many failed currency unions.

Greece alone, in the last 150 years, has already survived five state bankruptcies.

Germany, by the way, two in less than 30 years of the last century.

The common internal market Europe was created in 1992 already, without the Euro. It is since presenting, with equal chances to all, as well for the Germans, and as well as for all participating other Europeans, the free and unhampered flow of goods and services, and of capital, and of labour, and at the same time with the freedom of establishing a business - and this for 27 European countries with almost 450 million inhabitants.

These factors, of the free flow of goods and services, and of capital, and of labour, with at the same time freedom of establishing a business, are much more powerful boosters of welfare and growth than the uniform currency Euro. Evidence for this is abundant. From these factors are profiting all the ten European Union member countries not participating in the Euro, as well among themselves, as well in relation to the 17 European Union member countries, which have the Euro.

Therefore, and with more courage, necessary corrections of the system of the Euro and of the system of the European state indebtedness, have to be allowed.

The euro, in its present form and constitution, can not be the final design and version.

Treaties have again to be abided by, and not broken.This will again create trust. Without trust, neither a free market economy can function, nor the western style democracy.

Mr Ackermann coined it last week into the following words:

European Stability will not be there without National Solidity, be it in the public or in the private sector.

And in the case of emergency, this Solidity must be created by coercion, by the Currency Union. End of quote.

The **G20** are the welcome attempt, to stabilise, and to move ahead, the world and the world economy, a difficult but necessary exercise in a multipolar world.

The G20 Summit a few days ago in Cannes has set new marks for the development of the financial markets, and has reinforced them:

The role of the IMF will be reinforced, eventually as well by providing more financial means to it.

The G20 shall establish an action plan for Growth and Employment.

29 explicitly named, and systemically relevant banks in the world shall, to put is simply, be built, and if necessary be rebuilt and supervised in such a way, that the taxpayer will not have to any more pay for them, if they fall into trouble.

Basel 3 will have to be put in place in line with the set timetable by the national regulators.

All standardised over the counter derivatives, until the end of 2012, have to be brought on central trading platforms and central clearing institutions.

For the regulation of the shadow banking system the recommendations of the Financial Stability Board are being supported, and they shall be developed further during 2012.

Back to Germany:

The federal parliament, two weeks ago, has finally passed the reform of insolvency legislation. More corporations in trouble, shall in future be allowed to get restructured, instead of having to be bancrupted immediately.

The German insolvency legislation has been moved closer to the Chapter Eleven regulation in the USA, which is meant to improve the chances for survival of corporations.

So the Law has the expressive title: Law for the Further Facilitation of the Restructuring of Enterprises. There is no word of insolvency any more in the title of the law.

Debtors shall be encouraged, to early enter into procedures of insolvency, in order to increase chances for survival. In future they can move under a protection umbrella. Then their liabilities for payment will be halted for a period of time. In the meantime, a business administrator, to be named by them, will surveil the business.

If possible, the management shall be allowed to continue to manage the business under own responsibility, and at the same time set up an insolvency plan. Creditors, who are not agreeing to the bailout plan, can now easier be voted out, and they have less legal means against this now. For old owners it is now also more difficult, to withstand a forced conversion of unpaid receivables into equity (debt equity swap).

The Association of Insolvency Administrators Germany has stated that the reform of the law is a succesful compromise between all interested parties.

The Association also is calling for the introduction of a Procedure for the " Orderly Insolvency of States" in Europe.

As deterrent disorderly state insolvency is named the example of Argentina. Here, 10 years after the state bancruptcy, still owners of receivables exist who are not legally and economically giving up their claims.

The Association of Insolvency Administrators is recommmending the German insolvency law reform, with its combination of insolvency plan, own management administration, and council of creditors, as a regulation tool for states. However, a legal court, independent from states and from creditors, would, in addition, have to be installed.

In conclusion, some statements from the Statement of the German Central Bank, the Bundesbank, from last week in its Financial Stability Report 2011:

The Bundesbank is regarding the high indebtedness of states, and the concomitant loss of confidence in the European banking system, for the forseeable future as the largest burden for the German and the European financial stability.

As a positive, the following is reported: Between spring 2008 and summer 2011, a group of 13 large, internationally active German banks has increased its core equity ratio under the presently applicable Basel 2 regulations from 8,1 % to 13,1 %.

The leverage degree - as measured by the relationship of balance sheet total to core equity - is said to have decreased from 43 to 33. The risk weighted assets are said to have also decreased, so that the equity capital requirements are lower now by almost 30 %.

This gives rise for hope for stability.

Source: *Reprint of part of a presentation by Helmut Schnabel, given at the November 14, 2011, Annual Meeting of Members of the Association of Chief Financial Officers Germany.*

Dr Andreas Dombret
Member of the Executive Board
of the Deutsche Bundesbank

Back home: making the G20 Summit commitments work

Euro Finance Week
in Frankfurt
Tuesday, 15 November 2011

Deutsche Bundesbank • Communications Department • Wilhelm-Epstein-Strasse 14 • 60431 Frankfurt am Main • Germany
www.bundesbank.de • E-mail: presse-information@bundesbank.de • Tel: +49 69 9566 3511 • Fax: +49 69 9566 3077
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1 Introduction

Ladies and gentlemen,

The recent G20 Summit in Cannes was another decisive step towards a more resilient international financial system. The work to develop a new regulatory framework is slowly but surely nearing completion.

Nevertheless, we still have a long way to go to make the commitments work back home. Ultimately, it is the globally consistent implementation and transposition of the agreed policy measures into national laws and regulations that will count. In terms of effectiveness and consistency of these internationally agreed reforms and standards, it is therefore a great plus for the international community that the FSB is strengthening its implementation monitoring.

I would like to focus on three key areas where consistent implementation is most critical:

Deutsche Bundesbank • Communications Department • Wilhelm-Epstein-Strasse 14 • 60431 Frankfurt am Main • Germany
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(1) addressing the risks posed by systemically important financial institutions (SIFIs for short),
(2) strengthening oversight and regulation of the shadow banking system and
(3) putting into effect the new capital and liquidity standards for banks, known as Basel III.

I would now like to briefly discuss these areas in more detail.

2 Dealing with SIFIs

The past few months have witnessed substantial progress in tackling the SIFI problem. In Cannes, the G20 endorsed the comprehensive policy framework presented to them by the Financial Stability Board (FSB). The requirement for SIFIs to hold additional capital above the Basel III minimum standards – which was specified by the Basel Committee on Banking Supervision – lies at the heart of this concept. To this end, an initial set of 29 global systemically important banks has been identified. To take account of dynamics within the financial system, the set will be updated annually with respect to its number as well as its composition.

SIFIs will have to meet the additional loss absorbency requirements with common tier 1 capital, which is a particularly good buffer for covering losses. The specific amount will be determined on the basis of each SIFI's systemic importance, currently ranging from 1.0% to 2.5% of risk-weighted assets.

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I very much appreciate the FSB's recommendations, as such capital add-ons are an appropriate measure for improving the resilience of SIFIs, forcing their owners to take greater responsibility for their actions. Moreover, they put a price tag on the implicit government guarantee that SIFIs enjoy, thereby reducing misguided incentives to take excessive risks and countering competitive distortions.

Nevertheless, it was clear from the outset that strengthening SIFIs' loss absorbing capacity would not be enough. We should remember and be very clear that failures are part and parcel of a market economy. Unfortunately, the crisis has revealed a significant lack of suitable instruments for effectively dealing with failing financial institutions. These gaps in legal frameworks must be addressed. SIFIs, too, must be able to exit the market in an orderly manner that does not expose taxpayers to the risk of loss.

A number of jurisdictions have already adopted legislation to improve their resolution regimes. For instance, the German Restructuring Act, which came into effect at the beginning of this year, includes a significant extension of supervisory powers, allowing authorities to restructure and resolve banks. Yet, despite the progress made at national level, obstacles to the effective resolution of financial institutions remain. National resolution regimes are clearly stretched to their limits when it comes to globally operating SIFIs. One of our main tasks in the coming months will therefore be to ensure mutual compatibility between different national resolution regimes.

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In this regard, the *FSB Key Attributes of Effective Resolution Regimes for Financial Institutions*, which were also endorsed by the G20 in Cannes, represent a major leap forward.[1] The Key Attributes constitute a new international standard and serve as a point of reference for the overhaul of national resolution regimes, setting out elements needed for enabling the orderly resolution of financial institutions, irrespective of their size or importance.

The Key Attributes require jurisdictions to have a designated resolution authority in place that possesses all necessary powers to intervene in and resolve financial institutions that are no longer viable. This includes specific legal powers as well as the operational capacity to implement orderly resolutions. In addition, for internationally active firms, institution-specific cross-border cooperation agreements should and will be established. The Key Attributes also call for the establishment of Recovery and Resolution Plans (RRPs) for global SIFIs, supported by resolvability assessments to evaluate the feasibility of resolution strategies. The objective of these plans is to organise the recovery or resolution *ex ante* in such a way that systemically important units or functions can be maintained without systemic disruptions.

Following their endorsement by the G20, the Key Attributes now have to be put into effect across jurisdictions. This will require substantial efforts by both national authorities and financial institutions. Legislative changes will be needed in many jurisdictions to ensure that national authorities can exert all necessary powers. Recovery and resolution plans must be developed and,

[1] See Financial Stability Board, Key Attributes of Effective Resolution Regimes for Financial Institutions, October 2011.

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finally, financial institutions may need to change their structure and operations to ensure their resolvability.

Looking ahead, the FSB framework will be extended from global to other SIFIs. In Cannes, the G20 called on the FSB to deliver, by April 2012, possible ways to broaden the framework to include banks that are systemically important at national rather than international level. Furthermore, there are concrete plans to include, in the medium term, other financial market players such as insurers, financial market infrastructures and non-bank financial institutions.

3 Illuminating the shadow banking system

The next challenge I would like to address is the need to look beyond the banking system and to illuminate what is known as the shadow banking system. We should bear in mind that the shadow banking system is not a new, autonomous part of the financial system. Most entities and activities ascribed to it are already subject to some kind of monitoring and regulation.

Yet the crisis has made it painfully clear that the shadow banking system can become a source of systemic risks and endanger the entire financial system. To reduce these risks, gaps and loopholes in the existing regulatory framework need to be closed. Undoubtedly, we have to act fast, as the stricter rules imposed on banks via Basel III and the rules for SIFIs clearly pose the risk of activities being shifted to less regulated areas. We must not allow risky behaviour previously taken on by banks to be pushed into the dark.

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Much work has already been done in this respect. In Cannes, the G20 endorsed a comprehensive set of recommendations put forward by the FSB. These recommendations call for both an effective monitoring of the shadow banking system and, where necessary, regulatory measures.[2] To improve monitoring, the FSB has set out high-level principles for the relevant authorities and a stylised monitoring process. The FSB will conduct annual monitoring exercises to assess global trends and risks in the future. The results of these global assessments will be reported to the G20.

Getting back again to national authorities: their main task is now to implement the FSB's recommendations for effective monitoring in a timely and internationally consistent manner. In order to gain a comprehensive picture of the shadow banking system and the risks it poses, authorities must put in place an appropriate system-wide oversight framework. Ensuring that national authorities have sufficient powers to collect all necessary data at an adequate frequency is of utmost importance in this context.

Yet improving data availability will require substantial efforts. For instance, in order to obtain a picture of the shadow banking system's scale, national authorities must be able to draw on high quality, consistent data on financial sectors' assets and liabilities – this is known as Flow of Funds data. Unfortunately, in many countries a number of limitations in the Flow of Funds statistics have come to light. Aggregating or comparing these data across jurisdictions has proven to be especially difficult.

[2] See Financial Stability Board, Shadow Banking: Strengthening Oversight and Regulation, Recommendations of the Financial Stability Board, October 2011.

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Furthermore, *better monitoring* of the shadow banking system will not be enough; *better regulation* will be needed too. This could be achieved either by regulating banks' interactions with the shadow banking system or by regulating activities and participants in the shadow banking system themselves.

The FSB has already initiated work to assess the potential case for regulatory actions. It has set out general principles for designing and implementing regulatory measures in order to strengthen international consistency and to reduce opportunities for regulatory arbitrage. Over the coming months, the FSB, together with competent standard setting bodies, will issue a series of studies and recommendations for regulatory actions which will deal with identified gaps and with inconsistencies in national regulatory approaches. These recommendations will then, once again, have to be implemented at regional and national level, calling for further substantial changes in laws and regulations.

We should keep in mind that, when designing new monitoring and regulatory measures, our actions must be forward-looking and we must be mindful of unintended consequences. Given the fluid, evolutionary nature of the shadow banking system, we should not focus solely on risks which have come to light during the current crisis. We have to be sufficiently flexible to capture future developments as well. In this respect, exchanging information across jurisdictions on a regular basis is crucial.

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4 Implementing Basel III

I would like to finish with a few words about the new capital and liquidity standards for the banking sector, commonly known as Basel III. The new rules represent one of the key pillars of financial sector reform as they will significantly strengthen banks' resilience by raising quality, quantity and international consistency of bank capital and introducing global liquidity standards. Last year, at their Summit in Seoul, the G20 committed themselves to implementing the new framework.

Unfortunately, over the last months, some market participants have raised fears that Basel III might hamper economic recovery or would damage national interests. Yet this is not the case. The new rules are indispensable for improving banks' resilience and will generate substantial benefits by reducing the likelihood of financial crises as well the output losses associated with such crises in the future.

I therefore warmly welcome the fact that, in Cannes, the G20 leaders took the opportunity to call on jurisdictions to meet their commitments to fully and consistently implement the new Basel framework within the agreed timeframe. Individual countries should not seek to gain advantages by watering down or reluctantly implementing internationally agreed reforms.

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5 Conclusion

Ladies and gentlemen,

To sum up:

The cornerstones for making the financial system more resilient are now in place. Nevertheless, much remains to be done. We must put our commitments into practice and translate the agreed reforms into national laws and regulations. In particular, we need

- to ensure that *all* financial institutions can be resolved without destabilising the financial system,
- to better illuminate the shadow banking system and put in place regulatory measures where necessary and
- to implement the new Basel framework consistently across jurisdictions.

Thank you for your attention.

* * *

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"We Want To Increase Cross-Selling"

Vittorio Ogliengo, head of F&A at UniCredit, shares his views on profitable banking services and the beauty of being a CFO.

By Steven Arons

>> Mr Ogliengo, you used to be a CFO. What do you miss most about that job?
<< One of the things I miss is being involved in big capex decisions. I remember when I was at Barilla we decided to build our first big plant in the US. It was an intense time because we knew that making a mistake with this investment would cause problems for the entire group.

>> How does this experience shape the way you do business today?
<< It is clearly an advantage to know the other side of the bargaining table, to understand the special challenges of your business partners, such as those relating to tax, treasury and accounting decisions. The CFOs really appreciate it when you are able to provide in-depth knowledge on these topics along with the banking expertise.

>> What is the typical customer of the F&A unit headed by you?
<< Unlike many other investment banks we at F&A work with a very wide range of customers that can go from EUR 50 million up to a multinational corporation. I continue to meet with mid-cap clients, not just the very big ones, because this gives you a good understanding of what is going on in each of the markets that we operate in.

>> There is a trend toward bonds and away from lending. How is this affecting your unit?
<< Clearly, in the current situation, where there is ample liquidity in the market and very low interest rates, it is attractive for corporations to issue bonds. But there is a trade-off: unlike lending, bonds do not create a long-term relationship with a bank and are less flexible. But of course I am more than happy when we as a group manage to issue capital market products as a result of our lending relationships.

>> Do you expect a shift back to lending?
<< Lending is picking up because the economy is growing. In addition, not everyone has access to the bond market, especially not the mid-caps. This means we will slowly start to increase our loan book again.

>> Your loan book shrank by 2 per cent last year. What do you expect for 2011?
<< We foresee moderate growth hand in hand with stronger economic growth.

>> If clients are pleased, they won't be reluctant to award us additional advisory business. <<

>> The core markets of UniCredit are Italy, Germany, and Central and Eastern Europe (CEE). Which ones will the grow the most?
<< Germany will be the star performer for us and the entire group, not least because of our large presence there. Then comes Turkey, followed by Poland and Russia. We are among the top-three banks in each of these countries.

>> Russia's biggest banks, VTB and Sberbank, are heavily supported by the government. Is is possible to compete?
<< Yes, because we bring in the international expertise from our network, for example in project and commodity finance. But we do not compete for plain vanilla products, which are mispriced for us, especially if you factor in the elevated country risk.

>> Your M&A advisory business is strong in CEE but less so outside. Are you content?
<< We do not want to be a global player in M&A; nevertheless we have a strong franchise in our footprint already and leading positions in the business in Italy and CEE and strongly growing ones in Germany and Poland. As for CEE, although the transaction sizes are not very big yet, it is a very interesting market for us, as we can take advantage of our presence in 19 countries there. Not only does M&A advisory generate fees; it also helps us deepen the relationships with our customers, thereby paving the way for more cross-selling.

>> Do your clients understand the need for cross-selling?
<< It usually goes without much saying though sometimes we will have to raise it with our customers. We are a financing powerhouse with a loan book of over EUR 300 billion. Being the lending unit, we guarantee the long-term relationships with our customers that my colleagues responsible for the other global product lines at UniCredit can tap into. For example, we would not like to bridge a corporation's bond if it issues it through a rival bank; we would like that company to turn to us to meet its needs.

>> Some politicians have been calling for new barriers to M&A. Are you worried about an era of M&A protectionism?

<< My view is that it would be wrong to go down the road of protectionism. It is contrary to our interests as a big regional bank. But as our CEO recently pointed out, we need reciprocity at the European level.

>> European M&A activity is still slow. Have we lost our appetite for deal making?
<< No, but there's still some uncertainty. To the extent that trust is coming back, so will M&A. I personally see a solid year 2011 and a promising 2012. However, the rationale of the deals has changed a little. Before the crisis, M&A was often driven by a hunt for market share; now it is more about cost synergies.

>> Many recent deals have been based on shares, not cash. Is this a problem for you?
<< You rightly imply that we have seen more profitable days, but even if the business on a stand-alone basis may be less lucrative than before, as stated, we tend to combine advisory with lending business and make sure that the overall profitability is economically viable per client. When the client is pleased with our overall services, he or she is not reluctant to award us additional advisory business.

HVB - UniCredit Group

The advisory adept

Vittorio Ogliengo has been the head of UniCredit's lending and corporate finance unit Financing & Advisory (F&A) since 2009. F&A is a global product line of Unicredit´s CIB division, managing a EUR 300 billion loan book and the group´s M&A franchise. Mr Ogliengo joined the bank in 2005 from the Italian pasta maker Barilla, where he served in many senior financial positions, including as CFO of the holding. His previous career stops were with Fiat, Citibank and PwC.

Financing & Advisory is one of three global product lines of UniCredit's Corporate and Investment Banking (CIB) division, along with Markets and Global Transaction Banking. Last year, CIB contributed EUR 6.7 billion in operating profit to the group total of EUR 10.9 billion. Jean-Pierre Mustier took over as the new CIB division head in March this year.

>> UniCredit is the project finance MLA for the North Stream pipeline. How difficult was it to integrate political and environmental factors into your credit decision?
<< We as advisers on the project have to take these things into account, and I believe one of the reasons why we were chosen is because of our familiarity with each of the territories that the pipeline will run through.

>> Will the new capital requirements under Basel III force you to shift your focus from lending to advisory?
<< As we are not purely an advisory firm, it is less common for us to offer advice to our customers without combining it with lending. But our current aspiration is certainly to increase our cross-selling, meaning to offer various products to our clients, not just lending, and especially capital-light products such as financial advisory and M&A, or cash management and e-banking. This will require strong coordination within our network but also a more selective approach towards our customers. If we cannot encourage them to do enough business with us, the economics will not work. The fact that many banks are raising capital, which makes it harder for them to reward their shareholders, is putting a natural limit on how deep you can go on pricing.

>> And F&A compared with the capital markets unit of UniCredit?
<< Basel III will certainly benefit the capital market business. But again, without our lending activities, it will be difficult to convince a customer to choose UniCredit for their capital market transactions. Our businesses have to grow together. ||

USA, Article: The Soft Expropriation of the Savers

How America once lowered its high state indebtedness, to invest in gold was forbidden to private investors until 1974

by Philip Plickert, Frankfurter Allgemeine Zeitung

Never, in peace time, the stat e debt has been as high as now. The US American state debt quota is approaching the 100 % mark as measured against gross domestic income, GDP. The United States, however, have managed formerly to get down even more enormous debt mountains. After the Second World War, the state debt quota, for a short period, had even increased to 120 %. The government, however, could bring it down thereafter quickly. Still, the situation in the post war decades has been quite different from today. At the time, strong growth did help - and inflation in connection with interest rate caps. By way of the pretty high devaluation of the purchasing power of the currency, the real debt burden of the states decreased.

The soon chronic inflation did not lead to increasing interest rates, and this had a reason, which today is almost forgotten: " financial repression " by the states.

Through a series of laws and decrees, the states discretely exercised pressure on the investors and savers, so that these invested in their low interest bearing bonds, although these often earned less than the inflation rate. This, the American economists Carmen Reinhardt, the co-author of the famous Rogoff-book about historic debt crises, and M. Berlen Sbrancia, have analysed lately.

For instance, banks and insurance companies had been forced, to invest a certain part of their assets into state bonds " because of liquidity and security reasons ". For bank deposits there existed an interest rate cap. Capital controls prevented an outflow of money from the country. And gold, as a possible alternative investment and hedge against inflation, was forbidden to invest in for private investors, in the USA until 1974.

According to calculations of Reinhardt and Sbrancia, in half of the developed economies from 1945 till 1980, the real interest rates had been negative. This means, the inflation rate was higher than the nominal interest rates on government bonds. So the highly indebted states managed to drastically lower their debt burden. Supported by strong growth rates after the war, the USA could almost halve their state debt quota down to 60 %. In the seventies, the state debt quota sank further down towards 30 %.

Even more drastic was the situation in Great Britain: There the state debt quota at the end of the war was at unbelievable 235 % of GDP, it went down until the mid fifties to 160 %, and then fell in the seventies below 50 %. Growth and inflation helped the state, to get down its indebtedness.

The " financial repression " effectively worked like a hidden tax on (forced-) investors. The maximum interest rate, through the " Regulation Q ", was since the middle of the sixties

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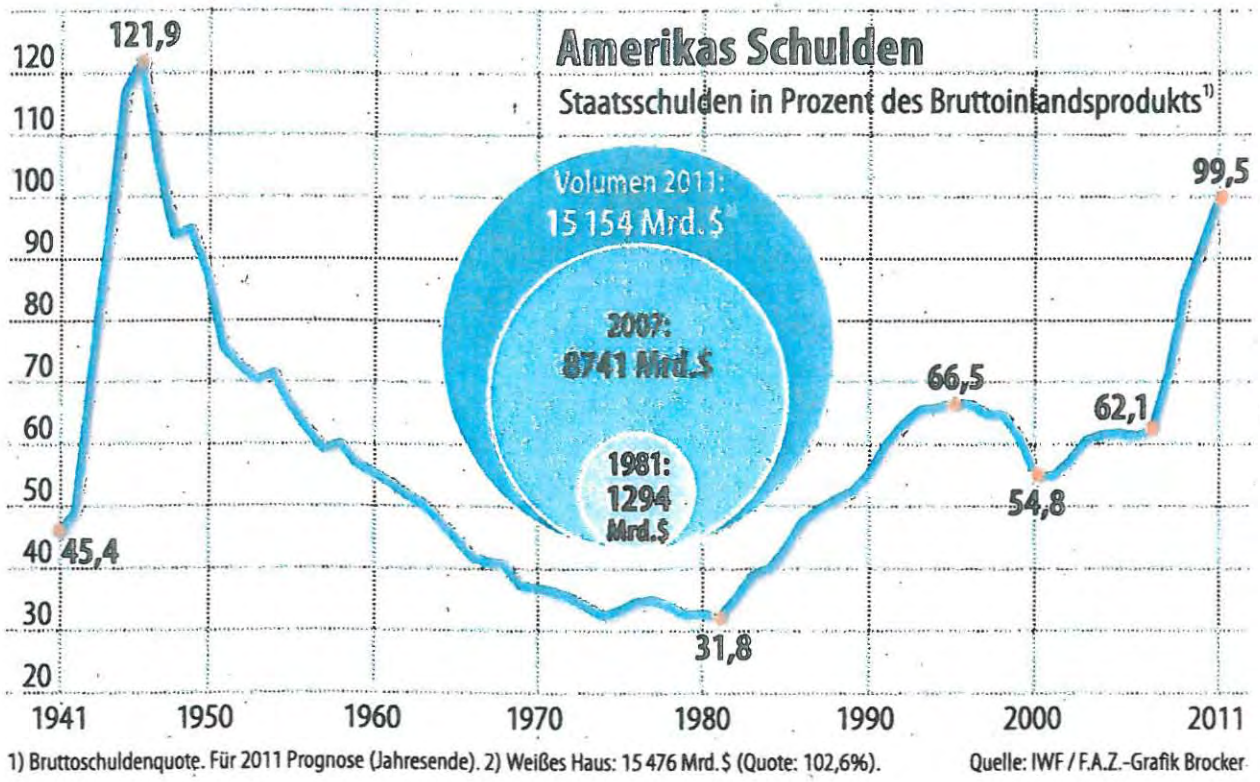
America`s State Debt

State Debt in % of GDP [1]



Footnotes: 1) Gross state debt quota. Forecast for yearend 2011

2) White House: 15 476 billion US Dollars (quota: 102,6 %)

Source: IMF / F.A.Z.-Graph Brocker

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significantly below the return of government securities, so that many savers recurred to these, also low interest bearing, securities. The hidden tax on the savings was easier to execute, than a tax for all tax payers and the cutting back of state expenses, do write Reinhardt and Sbrancia.. According to calculations of the two economists, the " financial repression " made it possible for the USA and for Great Britain, to reduce their state debt burden through negative real interest rates by 3 to 4 %, annually

The " financial repression " was, until the seventies, a global practice, as Reinhardt and Sbrancia elaborate. Since the liberalisation of the capital markets in the eighties, however, the times of stately forced low interest rates are over. Capital can escape, when there are too tight fetters in one country.

Some elements, however, of " financial repression " do still exist until today, for instance the structural preferring of government bonds, by way of low regulatory requirements for underlying refinancing equity for banks, or similar quotas for insurance companies. In some emerging markets like in China, the government is openly exercising pressure on the banks, in order to be able to refinance itself favourably. And in Japan, the state owned post bank is one of the main creditors of the highly indebted state.

Since the breakout of the financial crisis, the central banks in the western countries have started with a direct financing of the state: The Purchasing program of the American Central Bank Fed is part of this, which, alone with the second wave of " quantitative easing ", has bought government securities with the value of 600 Billion US Dollars. In the meantime, central banks are holding almost half of the marketable American government securities, are pointing out the economists of Commerzbank.

Without this interference in the bond market, the interest rate for the American treasuries would be 70 basispoints higher. Then the burden of the debt servicing would be considerably heavier for the American minister of finance.

Source: Frankfurter Allgemeine Zeitung, August 2 , 2011. All rights reserved. Copyright Frankfurter Allgemeine Zeitung GmbH. Provided by Frankfurter Allgemeine Archiv.
Responsible for translation: Gefiu; translator: Helmut Schnabel

IAFEI News **November 20, 2011**

IAFEI Board of Directors Meeting, Beijing, China, September 16 , 2011

Traditionally a physical IAFEI Board of Directors meeting is being held on the occasion of the annual IAFEI World Congress. The 41st IAFEI World Congress took place in Beijing, China, September 16 to 18, 2011. The concomitant Board of Directors meeting took place on September 16, and 18, 2011. This Board of Directors Meeting made the following elections/ reelections of IAFEI Officers, for 2012:

Elections, reelections of IAFEI Officers, for 2012:

Hiroshi Yaguchi, Japan	Chairman IAFEI
nobody elected	Vice Chairman IAFEI
Abelardo Cortez, the Philippines	Secretary IAFEI
Emilio Pagani, Italy	Treasurer IAFEI
Luis Ortiz Hidalgo, Mexico	Area President the Americas, IAFEI
Nguyen Ngoc Bach, Vietnam	Area President Asia, IAFEI
Armand Angeli, France	Area President Europe, Africa, Middle East, IAFEI

As interim Vice Chairman IAFEI for the remainder of 2011 was elected Mr. Luis Ortiz Hidalgo, Mexico.

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42nd IAFEI World Congress, Cancun, Mexico, November 14 to 17, 2012

IMEF, Instituto Mexicano de Ejecutivos de Finanzas, will organise and host this 42nd IAFEI World Congress.

On the occasion of this World Congress, the next IAFEI physical Board of Directors mmeeting will take place.

2013 IAFEI World Congress

Hosting member institute, and exact date, not yet determind.

2014 IAFEI World Congress, The Philippines

Hosting member institute will be the Financial Executives Institute of the Philippines, FINEX.   The exact date has not yet been determined.