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Brexit: The practical implications for cash management and FX

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The UK will formally leave the European Union (EU) at 11pm on Friday 29 March 2019. In theory, a transition period will then apply from that date until Thursday 31 December 2020. During this transition period, the UK would remain in the single market and the customs union, enabling the free flow of goods, capital, services and people between the UK and EU Member States to continue. The transitional period relies on a withdrawal agreement, however. If no withdrawal agreement has been signed by 29 March, there will be no transition period and the UK will instead face an abrupt 'no deal' Brexit.

While the UK's departure is imminent, the nature of its future relationship with the EU is mired in uncertainty, particularly with regard to what trade deal, if any, the UK is likely to strike before it leaves. With the end scenario unclear, businesses are concerned that they might have to navigate a 'no deal' Brexit. So how can they realistically prepare?

In this article, we explore the implications of Brexit for cash management and FX, and suggest some practical actions that treasurers can take to help their organisations manage their Brexit-related risks. We hope that it helps to inform your planning for the years ahead.

90% of treasurers indicated that they were not confident their peers are readily prepared for the outcomes of Brexit.*

Cash management

Treasurers can look to mitigate the risks associated with Brexit by reviewing their organisation's business and treasury models. Their bank relationship directors will be able to help them explore the available options. Key considerations include:

Legal entity and operational structures. Are the business's legal entity and operational structures fit for purpose in a post-Brexit world? If not, how can they be modified to ensure that the business can optimize its funding and liquidity management? Is it necessary to establish additional treasury centres in EU countries, for example? What safeguards should be in place to ensure that working capital will be available as and when it is needed?

Tax. The domicile of the business for tax purposes will impact on a company's cash pooling arrangements and also on its intercompany lending structure, particularly once the EU's cross-border interest and royalty payments directive ceases to apply. This directive abolishes withholding taxes on royalty and interest payments made between EU companies that are in the same group.

Banking systems. The business will want to maintain direct connectivity with the banks that it uses across Europe. So it will need its enterprise resource planning systems (ERPs) and treasury management systems (TMSs) to integrate with multiple banking partners. It will also need access its historical data so that it can analyse and forecast its data going forward to manage its liquidity positions.

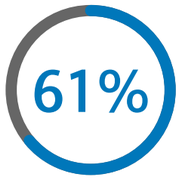
Financial modelling. The business should update its financial modelling and planning to reflect changes to its supply chain and business model as a result of Brexit, and to identify future short- and long-term financing and hedging requirements.This, in turn, may result in the business needing to adjust its cash pooling arrangements, particularly multi-currency arrangements, and to reconsider its lending limits to ensure that cash flow between group companies within the UK and the EU is managed effectively in future.

Bank account structures. The business will want to ensure that its subsidiaries within the EU 27 can access the EU payments schemes and make use of EU deposit and lending facilities. Treasury should consider how it would on board any new banking accounts in time to allow for payment capabilities to be set up. New documentation for loan facilities and risk management products may also be required. Additionally, the business might need to change its payment arrangements with its customers, including direct debits and standing orders.

Organisation and talent. Restrictions on freedom of movement will impact on the business's ability to recruit and retain finance and treasury talent. So it needs to plan ahead and source new recruitment channels, for example, by building relationships with European universities.

Geopolitical Change: Brexit

Treasurers need to holistically review their treasury model to mitigate the "worst-case" outcome. Dimensions to consider when reviewing existing Treasury set-up include:

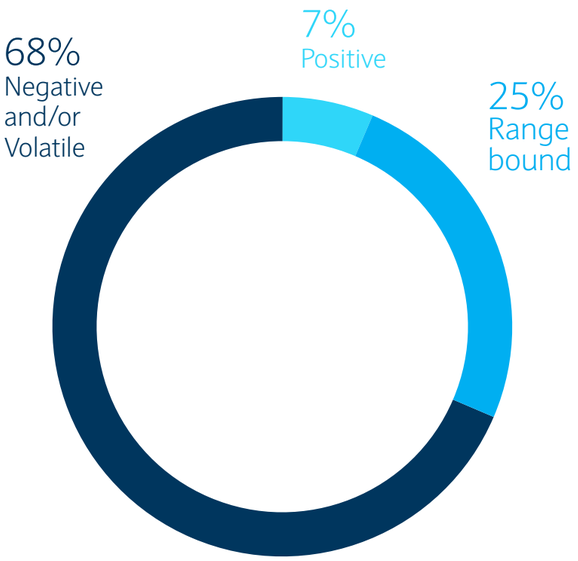


of treasurers do not, or are unsure of whether they have a cash management plan in place in the lead up to Brexit*

FX

The uncertainty around Brexit has weighed heavily on sterling since the EU Referendum took place in June 2016 and has resulted in the currency having a volatile relationship with the US dollar and the Euro, in particular.

Treasurers outlook on cable (GBP-USD) in the run up to Brexit*



While sterling is likely to remain vulnerable to political developments associated with Brexit for the foreseeable future, five other major macro themes are also influencing FX markets generally. These are:

Divergence of central bank policy. While the US Federal Reserve continues to raise interest rates at a brisk pace, the European Central Bank has been more dovish, as has the Bank of England, which raised rates in August for just the second time in a decade.

US politics. Concerns around trade wars and protectionism are impacting on the FX market. The US, China and the EU have all announced new tariffs on certain imports, which could have the effect of slowing down global growth.

Commodity prices. Rising oil prices have inflationary implications, particularly for emerging economies that import the commodity in large quantities.

Market volatility. Notable examples of volatility in 2018 include the plunges of the Argentinian peso and Turkish lira. Volatility is being driven by expectations of interest rate hikes, the strength of the US dollar, which makes it more expensive for emerging markets to repay their debts, and rising inflation.

Geopolitical tensions. Notable tensions exist in some significant markets, including Germany, Italy and Sweden. The Middle East is still volatile and tensions in the region have been heightened by the US pulling out of the Iranian nuclear deal. Additionally, North Korea and Russia remain unpredictable actors on the world stage.

So how can treasurers manage their FX risk effectively?

1 **Consider hedging to mitigate sterling volatility.** By undertaking a cost-benefit analysis, ideally with the assistance of the business's FX dealers, treasury can understand how much sterling exposure the business should look to hedge, if at all.

2 **Review the supply chain to reduce risks related to sterling volatility.** Collaboration between treasury and procurement could identify opportunities for onshoring or offshoring of expenditure that reduces sterling-related risks.

3 **Review FX budget rates more frequently.** In this volatile environment, treasury should be reviewing its FX budget rates regularly, in consultation with its FX dealers, to ensure the business takes decisions based on the most up-to-date currency outlook.

4 **Adopt an agile pricing policy.** Treasury can work with marketing to review pricing policies in light of currency changes and to potentially pass on pricing benefits to the end customer to gain market advantage.

5 **Stress test key ratios.** This will help to identify the impact of FX volatility on the balance sheet and ensure that the business is not in breach of any internal metrics or external covenants.

Planning ahead

Since much is still unknown, it is impossible for businesses to plan for every Brexit scenario. They can, however, mitigate some of the associated risk by reviewing their processes and structures and talking through the different options with their third-party partners, including banks.

How Barclays can help

Barclays remains committed to serving our clients in the UK, the EU and internationally – and can ensure continued banking services to our clients whatever the eventual Brexit outcome.

Regardless of the eventual Brexit outcome, Barclays remains fully committed to serving our clients in the UK, the EU and internationally and are taking actions to ensure we can continue to provide the best solutions for your business.

If you want to find out more about how Barclays can help you with Brexit planning, please speak to your relationship director who will be happy to help.

Barclays' commitment to our clients

Providing continued access to EU-27 financial marketing

We are engaging with our regulators to extend the services of our fully licensed banking entity in Ireland, to ensure continued access to the EU-27 financial markets. Should the UK's withdrawal from the EU result in a loss of relevant passports for the industry, the entity would be able to provide our clients with the gateway to European markets, including intra-Eu payments, lending and deposit-taking.

Enhancing product propositions

We continue to develop specific propositions for our corporate clients to meet their funding, cash management and risk management needs, and continue to add innovative solutions to help them navigate potential changes.

Investing in the European business

We continue to invest in our European business and are rolling out a consistent product suite across all major European geographies so that clients can enjoy the same level of service regardless of their location.

Helping our clients navigate uncertainty

While Brexit unfolds, we stand close to our clients in helping them understand the potential impacts on their underlying business - and corporate treasury - models, and will support them in delivering solutions to help them manage changes in their supply chain from our suite of trade and working capital financing, payments, and liquidity solutions.

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*Of a sample 182 treasurers that participated and engaged in the webinar "Considerations in the lead up to brexit". Recorded on the 5 July 2018