

# CURRENCY CONSIDERATIONS FOR FOREIGN REPATRIATION

Thursday, June 14, 2018 | 2:00 PM EDT

## **Paul Toth:**

Good afternoon, everyone. Thank you for joining us, and welcome to our PNC Advisory Series webinar, Currency Considerations for Foreign Earnings Repatriation. My name is Paul Toth, and I'm a manager in the Foreign Exchange area at PNC, and I will be your moderator today.

Before we get started with our presentation, I want to highlight PNC's ongoing commitment to providing market insights, new ideas and best practices like you're about to hear. Our commitment is reflected in the types of conversations our bankers are having with companies like yours every day. It is also reflected in our PNC Ideas thought leadership series, which features a monthly e-newsletter, live webinars and a dedicated website at [pnc.com/ideas](http://pnc.com/ideas). From brief videos, articles and economic reports to financial market commentary and webinar replays, we continue to choose topics and formulate our ideas based on the input that we get from you. So at the end of today's session, please provide the feedback that we need to keep focusing on the right information for you and your company.

While we will broadly discuss tax law changes that may incent companies to repatriate foreign earnings, I would like to note that PNC does not provide legal, tax, or accounting advice on specific customer issues. Rather, you should consult your own legal, tax and accounting advisors with respect to the Tax Cut and Jobs Act of 2017 or any other specific legal or tax issues about how it pertains to your company specifically.

Okay, so with the admin out of the way, let's get on with the event. We're excited to have Tom McLaughlin and Katie Rodgers as our presenters today. Tom is a Managing Director and Katie is an Associate Director in the Foreign Exchange Group. Both specialize in providing foreign exchange cash management and hedging solutions to our corporate clients.

Today Tom and Katie will share their views and insights on the subject of repatriating foreign earnings that are held overseas and that are denominated in foreign currency. So to be clear, this webinar is specifically geared towards currency risk management and does not much address the repatriation of foreign earnings that are held in U.S. dollars.

In discussion, they will address the tax law changes and how corporate policies, hedging strategies and currency market movements may impact a company's ability to convert foreign earnings into U.S. dollars in order to repatriate them, both initially and on an ongoing basis.

Today's session will go for about an hour, so I will now turn it over to Tom to talk through the agenda and begin the discussion. Tom?

## **Tom McLaughlin:**

Thanks, Paul. The agenda will cover tax law changes, hedging policy and strategy, strategies for repatriation, market updates, best practices for trade execution. So let's get started.

As Paul mentioned, we'll cover a number of topics primarily related to repatriation of income earned overseas and held in a foreign currency. While there are other components to the Tax Cuts and Jobs Act, we will focus on the major foreign exchange implications for corporations and provide observations on ways businesses can actively manage their foreign investments, operations and strategies.

As background, let's discuss the Tax Cuts and Jobs Act of 2017 on a broad basis. This was signed into law by President Trump on December 22 of 2017 and was the first major transformation of the U.S. Tax Code since 1986. Congress has estimated that the 2017 bill will increase the government deficit by \$1.5 trillion in the next decade. The new law, which is effective January 1, 2018, may also have some impact for 2017 tax filings. It also has considerations for both corporations and individuals, but we will only discuss those related to corporations.

There are three main areas of focus. The primary benefit is the reduction in the corporate tax rate, which was reduced from 35% to 21%. The intent behind this tax reduction is to boost economic growth domestically by increasing the corporate earnings percentage. Corporations will thus have the ability to use the additional cash for working capital, acquisitions, share buybacks, dividends, employee bonuses and capital expenditures, amongst other things, which will then pass through the benefit to the greater economy.

The next area of focus is related to taxation of foreign earnings. Prior to the Tax Cuts and Jobs Act of 2017, the U.S. Tax Code operated under a worldwide system. This meant U.S. corporations owed federal taxes on all earnings regardless of where they were earned. The worldwide system incentivized U.S. corporations to hold cash overseas to avoid double taxation on foreign earnings. The prior law put the U.S. at a competitive disadvantage, as most other countries operate under a territorial system of taxation, where earnings are not federally taxed when repatriated. Under the new Act, U.S. companies will no longer be subject to federal tax on income earned overseas. This will allow U.S. corporations to bring back foreign earnings federally tax-free.

The Act also created the global intangible low taxed income, which allows the U.S. government to tax foreign income that is not repatriated to the U.S.. Thus there's no longer a tax incentive for corporations to retain non-operating cash overseas. Given the change in the law, U.S. corporations should assess whether or not it is optimal to continue holding cash overseas or to repatriate.

The third key point related to the Act is the transition tax. In order to account for corporate foreign earnings incurred prior to the Tax Cuts and Jobs Act of 2017, the new law imposes a one-time mandatory tax on undistributed income earned overseas during the period of 1986 to 2017. U.S. corporations will be taxed 15.5% on overseas income invested in cash or cash equivalents and 8% on overseas income invested in illiquid assets such as equipment. This tax applies regardless if U.S. corporations choose to repatriate foreign earnings.

Additionally, the transition tax can be paid in installments over an 8-year period. If so, 40% of the tax must be paid within 5 years, followed by 15%, 20%, 25% in the sixth, seventh, and eighth years, respectively. Thus corporations should begin planning how they intend to pay their transition tax. Whether in installments or a lump sum payment, previously trapped foreign cash could serve as funding for this tax by repatriating foreign earnings. Since the timing and amount of the tax are known, this provides corporations ease in establishing and implementing a strategy should they choose to repatriate funds to pay the transition tax. A similar strategy can be applied even if foreign funds are not used for tax purposes. Considering corporations will be taxed regardless if they elect to repatriate funds, management should begin to think about the most optimal place to hold cash for working capital.

These changes in the tax law present an opportunity for U.S. business leaders to put more cash to work and to bring home previously trapped cash. However, this new environment, while beneficial to U.S. corporations, will also require them to perform additional scenario analysis critical in determining the short-, medium and long-term effects of the tax change.

An additional work set that corporations will face related to the portion of foreign earnings that is denominated in foreign currency and now available for repatriation is the need to establish or revisit their foreign exchange hedging strategies and policies. Having a strategy and policy in place is necessary to manage working capital, remove market volatility, preserve value and avoid financial distress. Katie will address these topics specifically later on in the presentation.

Also, no discussion of hedging strategies can be mentioned without saying that it's important to ensure that you understand the accounting treatment of the various hedging instruments and potential strategies that you may adopt if you decide to hedge the conversion of foreign earnings for future repatriation.

So to continue to discuss the impacts of the tax law changes, let's discuss the repatriation of income earned overseas denominated in a foreign currency. A typical U.S. corporation should identify foreign exposures and seek to hedge those exposures in a way that is in line with the corporation's risk appetite and overarching business model. There are a variety of products and services available that can aid in managing foreign exchange exposure. Foreign contracts, option structures or a combination of the two can be used to preserve foreign earnings, protect project budgets and smooth earnings. This topic will be very relevant to many of our corporate customers who have accumulated large blocks of foreign earnings and have left them denominated in a foreign currency for overseas working capital or foreign investment. Katie will address these topics later on in the presentation.

Unlike the 2004 tax holiday, which only lasted for 1 year, there is no time requirement in terms of bringing back foreign cash. This has allowed our corporate customers to be more deliberate about both their short- and long-term strategies. It's likely that the short-term strategy will focus on the large blocks of cash that have built up and that are available for immediate repatriation. That approach will take into consideration, amongst other things, the instruments that those funds are currently invested in, keeping in mind that there may be early termination penalties for some of the investments. On the flip side, you'll want to give thought to how you will deploy the cash once it has been repatriated.

As for the longer-term strategic concerns, we've had a number of discussions with our customers related to developing longer-term monthly or quarterly hedge programs to repatriate future foreign earnings now that there isn't an adverse implication to doing so on a regularly scheduled basis. Having a predictable availability of foreign cash will provide a means for companies to pay down U.S. debt or restructure their balance sheets in a more efficient manner. If a foreign subsidiary of a U.S. parent company has temporary cash needs, swaps can be used to create inter-company loans to fund overseas operations on a short-term basis.

If a corporation elects to repatriate foreign earnings, the hedge policy, cash flow forecast and a budget rate should be established to facilitate the orderly repatriation of foreign cash. A typical corporation will forecast foreign earnings and then seek to preserve their value by locking into an exchange rate using a variety of hedging instruments such as forwards or options. In addition to these risk management products used to hedge future repatriations, corporations can also manage immediate repatriation in the spot market by targeting specific exchange rate levels by using resting orders.

Let's look at an example. With the tax law change, there will be a number of considerations in repatriating foreign earnings. As a sample scenario, Company XYZ is a U.S.-based company with a subsidiary in Canada. The parent company in the U.S. has a need for excess cash that's held in Canada to fund U.S. projects. The excess cash in Canada is held in Canadian dollars. XYZ will want to conduct a risk management assessment that includes identifying the risk, setting a hedge objective, implementing a strategy and identifying a method to track and measure performance. As part of the risk assessment, XYZ will need to consider other factors such as budget rates and timing--not only market timing, but also timing when the Canadian dollars need to be converted to U.S. dollars and available for use.

Keep in mind this example is clearly meant to be a broad-based illustration of a sample structure. However, our FX advisors are available to meet with you on an individual basis and review your specific situation to help you identify, categorize and quantify your international exposures. We hope that you reach out to us to collaborate in this regard.

At this point I'll transition to Katie, who's going to talk about hedging policy and strategies for repatriation.

**Katie Rodgers:**

Thanks, Tom. As Tom mentioned, there are several considerations when thinking about how to update your FX risk management policy. For those of you who don't have a hedging policy, it's a best practice when doing any kind of business abroad in the local currency to put an FX hedging policy in place which helps guide the decision-making process for currency conversion. The goal of many companies is not to trade on speculation, but rather to protect the cash flows and earnings of the company.

When thinking about hedging in general, it's best not to think about catching the market at the top or bottom, but to realize your budget rate and how much risk the company is willing to take. A hedging policy helps to put parameters in place so the decision-making process becomes streamlined. Elements of the hedging policy can include factors such as who can initiate and approve trades, what percentage of the exposure companies want to hedge, and even something as simple as which exposures make sense to hedge.

For example, companies will hedge their cash flows but not their translation exposure for some companies. This is one way to think big picture about how you will manage your international exposures. We won't go through the whole process of establishing a hedging policy and the components that come along with it since it is outside the scope of this webinar. We will, however, focus on Step 3, since repatriations will likely fall within this step of the process. The main focus of this step is to ensure transparency, clarity and consistency during the hedging process.

The step allows companies to think about those abnormal times in which you'll have to rethink your policy. It can act as a bumper to keep the company in line with risk management thresholds set by the board or management. This gives companies the opportunity to revisit policies that may not have been reviewed for some time. It's a best practice to review your hedging policies at least once a year as your company grows, changes country exposure, or views risk differently. A review of the hedging policy can help keep your company within its risk threshold. In the case of repatriation, the amount that you hedge may be larger than expected. Maybe you didn't include repatriations as part of the exposures you hedged in the past and want to add it in going forward.

Repatriations can be a one-time movement of money from overseas or an ongoing planned strategy. Given the recent tax changes, we've had more discussions with customers around strategic movement of funds. For example, I worked with a company that holds a Canadian account with excess funds in their Canadian operation. They were contemplating holding the funds in Canada while waiting for their best-case scenario rate and borrowing funds in the U.S. to fund projects. After running some scenario analysis, we determined that given the tax law changes and their borrowing costs, it would be more cost efficient for them to repatriate their Canadian funds at the current rate rather than borrowing in the U.S..

Given these scenarios, companies may want to explore other hedging solutions or execution strategies for repatriating the funds. Does your policy allow for only certain types of products to be used to manage risk? As companies become more sophisticated, their ability to look at other risk management tools can help them stay within the risk threshold. Generally, companies move from short-term solutions to more sophisticated risk management products as they become more comfortable with these products available.

So now that you have the strategy down, how will you actually get this done? When thinking about the products you'll use to implement your hedging strategy, it's a best practice to think about this in a longer-term fashion, which can have the added benefit of letting time help the market move in your favor. If you want to take this view of risk management, there is a whole suite of risk management tools available for the various situations. As Tom mentioned, unlike the tax holiday in 2004, as a part of the American Jobs Creation Act, there is no specified time limit on the most recent tax act. You have the time to evaluate your existing cash holdings and think strategically on how you want to handle the situation moving forward.

The most simple of these risk management products is the forward contract, which allows you to lock into a rate today for some point in the future. It's a great tool for a known amount of money that needs to be delivered at a specific point in time. If the amount and dates match, it's a perfect hedge against the value of the asset and helps companies to budget in advance the cost of payments abroad or the value of cash flows incoming. This is especially useful in a repatriation scenario. Since the fund will be moving from one account at your company to the other, there is little risk that you will later decide not to make that payment after it's been initiated.

Increasingly, cash managers are using swaps as a financing mechanism against short-term borrowings or to improve investment returns by consolidating surplus cash. The way to do this is a combination of a spot and forward contract. Prior to the tax act, I had a company who didn't want to repatriate their funds to the U.S. due to the high tax rate. Rather than permanently moving the funds to the U.S., they executed a swap to facilitate a hedge on an inter-company loan between the Canadian and U.S. entities. The U.S. entity pays a nominal interest rate to the Canadian subsidiary and now has use of the funds in the U.S. over the life of the loan. The Canadian amount the U.S. parent pays back to the Canadian subsidiary is locked in and known so they are able to budget for the eventual payback of the funds. Now with the tax changes, they would have likely changed their opinion on this scenario to repatriate and permanently reinvest rather than initiate the inter-company loan. With all the funds coming into the U.S., you can still use swaps as a tool to lend funds to international subsidiaries in under-funded markets.

Non-deliverable forward contracts work similarly to forward contracts but are typically used for illiquid currencies such as emerging markets. These customers use these for contracts to hedge exposures in Brazil, India, Malaysia, among many others. Settlement is done in U.S. dollars rather than the local currency to make you whole on the forward rate and then allows you to buy the funds on the spot market to make the payments.

Options also allow companies favorable rate participation and flexibility in the event that the underlying falls through, similar to an insurance policy. These contracts are best used when there is a contingency with the contract or the company is trying to achieve more favorable rates. This solution protects against adverse currency fluctuations on long-term pricing while adding some additional flexibility for which forward contracts do not allow. It's a viable strategy for repatriation by allowing you to participate in favorable rate movements and still protecting that worst-case scenario rate over the long run. Conversely, forward contracts are done at a specific rate, and they protect you against unfavorable rate movements, but they also do not allow for favorable rate participation.

There are multiple combinations of these products, from a vanilla put-or-call option, which locks in that worst-case scenario rate and allows for favorable rate movements, to option structures that can get more complicated. Some of these solutions require premium payments upfront, while others are zero cost. For example, a zero-cost caller allows the company to participate in favorable rate movements up to a specific rate while still protecting against that worst-case scenario, effectively trading within a band. Most forwarded options tend to be used for exposures for a year or less.

There is another structure derivative alternative that allows for long-term structured cash flows called a cross-currency swap. This allows you to hedge long-term payments, similar to a forward contract, and can be used as a viable alternative if you want to implement a long-term repatriation program or have long-term pricing protection.

Post Dodd-Frank, there are restrictions in terms of who can use which hedging products. Please consult with your FX partner in order to determine the appropriate hedging products for your particular situation.

Even with the best of intentions to hedge in the future, sometimes you're forced to move quickly on repatriation without the time to implement a longer-term risk management solution. The easiest way to do a currency conversion is a spot payment, as when you need the currency on the spot. A typical settlement is 2 business days, with the exception of Canada that's 1 business day, but can sometimes be done on a next- or even same-day basis in certain circumstances with specific currencies. The reasoning for the delay in settlement time is mainly due to time zone differences and language barriers. This is why you can't do same-day Australia, for example. It's already tomorrow in Australia.

There are a couple of ways to execute spot payments. The most common way to transact is via some form of an online platform, but many clients still call or email their trade requests in today. These trades will be done at current market rates at the time the trade request is made.

Alternatively, companies can execute utilizing the order book, which allows you to set a rate at which you want to execute. The bank will then work the order and contact you when that trade is executed in the market as the rate moves to your requested level. Execution is also done on a best-effort basis and is not guaranteed. If you put in a trade to sell euros at \$1.50, for example, you will have to wait until the rate hits that level before your trade will be done. This is a viable strategy when trying to protect yourself against a worst-case scenario, also called a stop loss, or catching the currency move in your favor overnight, even if we're all asleep. Just know that utilizing the order book does not guarantee that a trade will be done, as the market may not reach your level. It's a best practice to review your outstanding orders with your banks to ensure you still need those trades to be completed and they aren't duplicated with other transactions.

For the larger repatriations, this solution may not be the best option. For larger trades, the market may not react in ways you would see normally with regular-sized trades. To avoid markets reacting too strongly to the large position, sometimes clients will break up the trade into smaller pieces to avoid widening prices. Doing so is not easy with a resting order, so alternatively, you could ask your bank to work the order over time and execute it at an average price. I'll get into additional best practices when it comes to the trade execution portion later in this webinar.

In a large repatriation scenario, phone is one of the best methods of execution. It allows you that direct link to a person at the bank who can confirm rates quickly as well as assist with confirming the direction of trade and settlement date without the worry of putting something into an online platform indirectly.

Speaking of rates, I want to turn it over to Tom, who will review macroeconomic events that could affect rates in the future.

**Tom McLaughlin:**

Thanks, Katie. The market price of foreign currency will have a very direct impact on the dollar value of currencies held overseas, so it will obviously impact the amount and timing decisions related to conversion of foreign-denominated holdings. Therefore, we thought it would be helpful to provide a market update on a few of the most commonly traded currencies.

Broadly speaking, the U.S. dollar has strengthened over the past few months, which has had an adverse impact on those holding foreign earnings as the strength in the U.S. dollar has reduced the value of their foreign holdings. Katie had mentioned there are alternatives to capturing a market move in your favor, either through the use of the order book or through the use of various option structures.

We're going to focus here in the euro. The euro has fallen over 6% since hitting its 2018 high in early February. Throughout the first half of the year, weaker-than-expected economic data has sparked concern regarding the underlying health of the Euro Zone economy. Additionally, uncertainty over the United States' plan on tariffs has weighed on the euro.

A key driver of the currency as of late has been concerns regarding Italian politics. As the new Populist government is poised to take control, many fear that the anti-establishment government may attempt to steer Italy, which is the fourth-largest economy in the EU, away from the euro.

The G7 Summit, which was held on June 8 and 9, had turned out to be rather uneventful, with President Trump leaving early to go to Singapore for a historic meeting with Kim Jong Un. However, the recent trade situation will be something that will continue to be watched closely. It will also be important to pay attention to any updates from the new Italian government as well as any change in rhetoric from the European Central Bank. The European Central Bank met again today, with no change in policy. It is unlikely that we will see any substantive change in monetary policy until late next year, which is when the market expects to see some rise in interest rates.

Next we'll turn to the British pound. After surging nearly 7% against the U.S. dollar to begin 2018, the British pound has reversed course and has fallen roughly 6% in (inaudible) in mid-April.

As has been the norm over the past 2 years, political news out of Britain has continued to be a significant driver of the British pound. In the first half of the year, the currency managed to gain ground, primarily due to favorable Brexit headlines. More recently, the broad dollar rally, coupled with divisions among Prime Minister Theresa May's party, has contributed to the pound's reversal. Going forward, any substantive Brexit news is certain to be a catalyst for the pound.

Looking to monetary policy, the Bank of England met most recently on May 10 and left interest rates on hold. Despite less-than-stellar economic data recently, the Bank of England is aware that more interest rate hikes may be needed to contain inflation, which currently sits above the Central Bank's 2% target.

Unlike the euro and the pound, which are direct currencies, the rest we'll be focusing on are currencies quoted as \$1.00 per currency, meaning that when looking at the chart with an upward trend, it translates to U.S. dollar strength.

The Canadian dollar has fallen over the last few months, depreciating nearly 6% since its 2018 high in early February. As the U.S. dollar continued to recover, uncertainty regarding the ongoing NAFTA negotiations has continued to adversely affect the currency. Concern over Canada's housing market has weighed on the Canadian dollar as well. Home sales are down on a month-over-month and year-over-year basis. Going forward, rhetoric surrounding NAFTA and trade in general will likely continue to be a significant driver of the Canadian dollar. Additionally, we can expect to see the Canadian dollar continue to fluctuate with oil prices, as the correlation between oil and a commodity-dependent currency has strengthened significantly year to date. In regard to monetary policy, Canada's Central Bank will meet on July 11, with PNC economists expecting a 25-basis-point rate hike. Although the Bank of Canada is wary of raising interest rates too quickly given the record levels of household debt, the Bank of Canada is aware of the dangers of keeping rates at historically low levels.

The Mexican peso has depreciated over 13% since mid-April amid trade and political concerns. The Mexican peso hit its lowest level in more than a year this week when news broke that the U.S. may leave NAFTA and attempt to negotiate two separate free trade deals with Mexico and Canada individually. In addition to the ongoing NAFTA negotiations, the surge of far-left presidential candidate Andres Manuel Lopez Obrador has also contributed to the peso's decline. Any updates regarding the NAFTA negotiations will continue to move the peso. Significant changes in polling data for Mexico's upcoming presidential election, which will be held on July 1, could also affect the currency. In regard to monetary policy, the market is currently placing an 84% chance of a 25-basis-point rate hike at the Bank of Mexico's next policy meeting on June 21.

Shifting to Asia, the Japanese yen has fallen roughly 3% against the greenback year to date. With the Bank of Japan still maintaining their aggressive quantitative easing program with a combination of asset purchases and negative interest rates, much of the movement in dollar-yen is fueled by geopolitical fears stoking the yen's safe haven status and broader dollar trends. With inflation still far away from its 2% target, the Bank of Japan plans to continue its current monetary stimulus program. Bank of Japan Governor Kuroda is hopeful that inflation will pick up in the latter half of this year amidst a tightening labor market. Going forward, it will be important to keep an eye on fundamental economic data out of the U.S. and Japan as well as any change to Bank of Japan rhetoric regarding the path for monetary policy. Additionally, any flare-up in geopolitical tensions could cause investors to buy yen.

The Chinese renminbi has shown signs of strength thus far in 2018, gaining over 2% against the dollar year to date. One driver of the currency's strength has been the Chinese government's attempt to curb capital outflows by opening up China's equity and bond markets to encourage inflows. Additionally, there have been signs that China is once again focused on increasing the yuan's presence in global markets. Looking ahead, PNC expects that China, like other emerging markets, will see economic growth amidst tighter monetary and fiscal policy. It is widely expected that the People's Bank of China would raise its policy interest rate by 5 basis points to 2.6% today, partially in response to the 25-basis-point rate hike that the Federal Reserve announced yesterday. However, the People's Bank of China unexpectedly left rates unchanged, largely due to weaker-than-expected economic data and ongoing concerns relative to trade issues with the U.S..

If you would like a more in-depth market discussion or there are other currencies that you would like additional information on, please do not hesitate to contact your Foreign Exchange Advisor for that information. With that, I'll turn it back over to Katie to discuss best practices.

**Katie Rodgers:**

Thanks, Tom. If you're looking to do a trade that's out of the ordinary for you, as many repatriation scenarios at this point in time may be, it's a best practice to let your bank know in advance. This can include components such as larger-than-normal size, different products or risk management tools, or a longer time to settlement. Having these conversations upfront allows the bank the time to get all the requirements completed prior to trade, which helps to avoid any delays in execution while rates are moving. Certain requirements that can be worked out in advance include those listed on the slide.

Documentation: some products require additional documents in order to execute. If you've only ever done spot payments and want to start doing forwards, additional documents will need to be completed. If you've done forwards and now want to execute options, additional documents will still need to be completed. Having all this paperwork completed in advance will limit delays when executing payments.

For example, I spoke with a client for a few months about doing forward contracts if they landed a deal with a new customer where they would need to source materials from the UK. The client decided not to complete the paperwork in advance and subsequently won the deal. While this was a great win for the client, they were exposed to market fluctuations since they were delayed in processing forward contracts while waiting on appropriate people within the company to sign the documentation.

Credit: banks typically set a guidance line in place, depending on your normal trading volume. Talking with your bank in advance about how the expected value of the trade will help ensure approvals are in place prior to execution. Trying to get credit approvals on the fly typically delays the process and could make you miss out on a favorable market move.

Regulatory requirements: there really should be three, rather than two, certainties in life death, taxes and regulations. Your bank can help ensure that you are compliant with all banking regulatory requirements through active discussions. Not being compliant with regulatory requirements may have the same impact in delaying execution as any of the other previously discussed requirements.

Once you've made it through all the pre-trade approvals and documentation, it's time for trade day, and you'll want to consider the time in which you execute the trade. In general, it's best to trade in the morning hours while London is still trading. The extra liquidity in the market helps ensure better price competition. Keep in mind that fixes in certain currencies could cause volatility spikes. For example, there's a euro fixing that happens at 11 a.m. Eastern. Large trades will be moving through the market at that time, and volatility typically spikes.

Also be cognizant of Fridays. On Friday afternoons, the U.S. is the only market still open leading into the weekend. Liquidity runs thin throughout the day, and trade stops promptly at 5 p.m. Eastern. Don't leave your FX trades to Friday afternoon if at all possible.

This effect is compounded when you are shopping the rate with multiple banks. While it may be part of your policy to check rates with multiple institutions, keep in mind that for each bank you ask, the amount the market sees coming through is higher. If you're selling EU25 million, for example, and called four banks, it now appears in the market that you're trying to sell EU100 million and it will widen prices in the market, so be careful of competing against yourself. The Bloomberg screen that you'll see are other various rates that you'll find on the Internet typically are for round lots of roughly \$1 million. The larger amounts that you can do will widen prices.

Just as many of you take off around the holidays, so do market participants. Keep in mind that when holidays come around in these currencies, as they decrease liquidity in the market and introduce extra volatility. Many of you who import from China will know that the Golden Week is a roughly 7-day-long holiday where Chinese markets do not trade at all, so keep these holidays in mind.

On this slide you'll see a smattering of a few Central Bank meetings, data releases, and other holidays in July that could affect volatility in the market. This is a fairly typical example of the full calendar events that can affect prices in the market. Your FX provider can talk with you about the best time to trade along with all the other factors we have discussed in this webinar.

While we've mainly focused on transactions through the lens of repatriation, nearly all of these tips and strategies will work for a majority of cross-currency transactions, such as outbound payments, global M&A, and other international transactions.

We've covered a lot of material, including the tax changes, strategies for repatriation, market changes and best practices. We will now take the last few minutes to address any questions. I'll turn it over to Paul to facilitate.

**Paul Toth:**

Okay, Katie, thanks for discussing that topic. We're now going to transition to some questions and answers. So we have solicited questions from the audience in advance, and then there's also the opportunity for you to submit questions electronically by using the Q&A window located on your screen. If you do not see the Q&A window, simply click the Q&A widget found in the lower center portion of your screen. All right, so let's take a look at the first question we have here.

The first question is, "What trends are you seeing in foreign earnings repatriation?" So Tom, that sounds like some things you were discussing. Do you want to take that one?

**Tom McLaughlin:**

Yes, absolutely, thanks, Paul. As I mentioned earlier, unlike the 2004 tax holiday where many of our corporates rushed to repatriate foreign earnings prior to that 1-year deadline, today we're seeing a slower and more deliberate approach. It also seems corporates are taking their time as they're working to evaluate these alternatives. I would say anecdotally we have seen foreign acquisition, M&A activity, decline in 2018. It had peaked in 2015, when it was roughly \$5.8 trillion. What we're seeing, and my thought is a large reason for the decline is that there's really no longer an incentive to keep foreign earnings offshore, which has historically fueled some of that M&A activity as companies were looking for better ways to use excess cash.

**Paul Toth:**

I guess with the repatriation, it's really kind of taken a bite out of that use of that foreign cash. Okay. The next question is a little idiosyncratic, I guess, to the client, but they ask, "Can you suggest the best ways to repatriate Canadian dollars, British pounds, and Aussie dollars?" So I think we can address it broadly by talking about what are some things to consider when doing repatriation rather than focusing on those specific currencies. Katie, can you maybe talk about that in terms of maybe a strategy or policy formation?

- Katie Rodgers:** Yes, sure. Thanks, Paul. So as I mentioned in my previous presentation, so one of the first steps when looking at repatriating foreign earnings is to look at your current strategy and policy. Once that's been determined and those risk parameters are in place, the next step is to determine your budget rate relative to the current market rate.
- If you're ahead of budget and you've got funds available for conversion that you want to move, you may want to make a spot trade. If you're at or ahead of budget but the funds won't be available for conversion for a period of time, you may want to think about looking at a longer-term hedging structure. If you're behind budget and you don't necessarily need the funds immediately, you can opt to use an order book as a way to look at a specific level and get that kind of target rate that you're looking for. If you're using that order book, you may also want to consider that stop loss that I had mentioned previously, which kind of helps minimize your loss in the event of a unidirectional currency move.
- Paul Toth:** Okay, cool. The next question is just related to scale of these repatriations, and it says, "What is the potential scale of the amount of money to be repatriated, and what do you think the impact of that will be on the FX markets?" Tom, do you want to take that one?
- Tom McLaughlin:** Yes, sure. So it's estimated there's approximately \$3 trillion worth of foreign earnings that are held abroad. A good portion of that is held in U.S. dollars, and that part of it doesn't really impact the FX markets. However, there's still a significant amount that is held in foreign currency, and that amount remaining can have an impact on the market, as Katie had mentioned. It will certainly depend on size and time of day when a trade's executed. Clearly, you want to focus on some of the best practices that Katie had mentioned to avoid those.
- Paul Toth:** Okay. Okay, there's a question that says, "How can I sign up for market research from PNC?" I think there are several ways that you can do that. Probably the best and most effective way is simply to talk to your Relationship Manager at PNC or the Treasury Management Officer or Foreign Exchange Advisor that covers you. Any of these people can facilitate that request with our Economics Department. There's also links to it through PNCIdeas.com. You can go on there and you can request to be added to it as well. But I think the easiest way is just, if you ask anyone who's your primary point of contact here at the bank, we'll make sure that you get signed up.
- And there's a variety of different things. We do domestic economic analysis, we do currency forecasting. There are, through the FX Group, daily commentaries that go out as well as there are currency market updates that are specific to key movements that happen in the currency markets, and those are produced on an as-needed basis when there's a large movement in a particular currency rather than on a regular basis.
- So there's certainly a plethora of information, both on the website and that can be sent to you directly, and I encourage you all to reach out for that.
- Katie Rodgers:** And I think, Paul, one thing we can mention, too, is we can do market analysis for clients on an individual basis.
- Paul Toth:** Oh, sure.
- Katie Rodgers:** So first with the currencies you're exposed to rather than reading through a list of currencies that you may not be exposed to.

**Paul Toth:**

Yes, and that really strikes, I think, to our--the method in which we go to market, which is we try to be consultative with our clients. So to the degree that you're not just looking for general market research, but that you have a very specific agenda related to particular currencies that you're following, we can customize that analysis for you here from the FX desk.

Okay, so then the next question here. Thank you. That's sort of a repeat of a previous question. So, "How is this tax law different from tax holidays in the past?" I think we already addressed that, but I guess just to reiterate it?

**Katie Rodgers:**

Yes, I can talk a little bit about that. So as we mentioned, this tax act doesn't have a time limit, unlike other tax holidays in the past. You've got a lot of time to formulate your strategy, think about what you want to do, make sure that the movement of funds that you do decide to move is within your strategy, and it's really going to be more of a strategic move for you rather than trying to move and comply with a short-term timeframe.

**Paul Toth:**

Okay. Okay, there's a question that says that PNC is forecasting the euro's appreciation, it looks like, and there's a question as to why is that? So Tom, do you want to talk a little bit about that?

**Tom McLaughlin:**

Yes, sure, and there's a couple of things. So one is in the near term, the U.S. dollar appreciation was partially seen, as far as ECB remaining on hold, the U.S. dollar strength. However, as we look further out, the expectation is that the EU begins to raise rates over the longer term. I will say this, too, and this goes for all of the currencies listed. These forecasts come out on a regular basis, and we'll have another update here at the end of June, which will provide the current forecasts. So in preparing the deck, this deck was actually prepared just prior to the ECB and the Fed's most recent announcement, and I'm sure that our Economics Department is updating these, and I would expect that they'll probably shift a little.

One of the things that I would say is there's a few things that have been sort of weighing heavily on the euro such as what's going on in Italy and the continued uncertainty remaining with Brexit. And those two things, I think there is some speculation that by, if you look at they're talking here a mid 19 and high 19, hopefully, if those things have been resolved, the weight that they're placing on the currency would be removed. And if that's the case, then barring anything else, you would expect it to rally if those come up in a popular manner.

One of the things that is really interesting to note about Europe is the ECB has long maintained an unwillingness to create any sort of timetables around what they're going to be doing. And so the most recent statement, where they actually gave a calendar timeframe in which to change wouldn't happen, is a huge deviation from what we've seen in the past. And in my mind, knowing that and seeing the Fed's trend, I would certainly expect to see this a bit revised down. And I don't know that I personally would forecast such a large increase in Europe over time. Hope that's helpful.

Okay, the other question that someone is asking is, "Do you see anything new in terms of Brexit and their exit from the EU?" I guess in the near term, as I had mentioned earlier, that some of the debate amongst Theresa May's party is causing some concern as to how the negotiation's going to proceed. The one thing we do know is they clearly have a March of 2019 deadline, which they're actively working towards. I think any time there's uncertainty, and there's really just a lack of direction is another driver, as we've seen the British pound start to kind of feel some pressure as not only the U.S. dollar strength, but also that uncertainty, as you can see from the forecast, which again, to Paul's point, will certainly be adjusted. However, it seems like we're going to see--the expectation will be that the pound will stay in a relatively depressed mode for the short term until there's some definitive direction.

**Katie Rodgers:** And I think to the point of uncertainty, Theresa May and the negotiations for Brexit have turned into a lot more substantive agreements for the UK that a lot of the market didn't expect, so there has been some upside in terms of kind of what has been agreed to and what they think the Brexit terms will look like. I know a lot of people were expecting that hard Brexit, where there really wouldn't be a very good agreement. But now it's turning into more of a soft Brexit, where good terms have been put into place, Britain's getting a lot of what they want out of the deal rather than missing out on a lot of these terms and coming to March 29, 2019, with no agreement in place.

**Paul Toth:** Thanks, Katie. Okay, I think the next question, then, is, "What is the impact on inflation and interest rates relative to foreign earnings repatriation?"

**Tom McLaughlin:** Yes, Paul, I can take that. One of the things, the injection of cash in the economy in the near term from just general repatriation, the intent is to stimulate the economy, which will cause the U.S. to grow. That growth will lead to rising interest rates and rising inflation. At the same time, we've got to keep in mind that the economy's improvement is a catalyst for further interest rate hikes. And that certainly is assuming that, obviously, financial conditions remain as they are. As of yesterday, the Fed is pointing still towards two more rate hikes this year, which would bring the total to four for 2018. And again, those rate hikes theoretically will counteract the growth, to some degree, and inflation, and will help keep inflation around the Fed's 2% target rate.

**Paul Toth:** This one's back to policy. It says, "I'm interested in formulating a hedging policy for my company. Is there advice that can be provided to get me started in this process?" So again, I would say this is probably — in order to give a relevant answer to this question, it's probably something where it's best to actually set up a meeting with one of our advisors and talk through all of the things specific to your company so that it can actually be relevant to you. But broadly, I guess, Katie, that goes back to your thing. Is there any specific thing you could address broadly?

**Katie Rodgers:** Yes. On a broad basis, we do have some sample language that you could utilize for your own hedging policy as well as an idea of what other clients in the market have been implementing for their own hedging policies. So without naming names or sharing any kind of specific parameters, we can give you a general sense of what to think about in terms of the different risks that come associated with currency payments and setting that policy so that you know what risk to set those parameters around and kind of how your company wants to set those going forward.

**Paul Toth:** Yes. And that's a good point. And again, we don't just have a template. We probably have five or six that we use that some of which are very, very basic and very broad, and others of which are very detailed and very thorough. And so taking a look at a variety of different ways that other people have written these might be a way to help structure your own.

**Katie Rodgers:** Right.

**Paul Toth:**

Right. Okay. So there's that. There's another question that says, "Why is spot 2 days for FX?" So I think we addressed that in the meeting, but what I would say different from the rote answer that we gave is this. Spot FX is a market convention that has existed over time, and that generally grew up in an era where it was difficult to do global communications, and the speed of telecommunications and the advances in computer technology are greatly changing this. And so while 2 days is convention to give people of differing time zones the opportunity to settle things in a manner that works for banks that are effecting the transaction in the country of origin and in the country of delivery, I will say that this is changing over time. And I would expect that we start to see in the future this not be a 2-day time-frame. With the use of low-value payment systems, with some of the fintech advances that we're seeing, with the changes in the rails along which money is being moved internationally, I would anticipate a future where this isn't the same.

We're already starting to see an advent in payments in the U.S., where we have real-time payments going on. I would imagine that over time, you'll see this decrease. And even today, if you need to execute a transaction that settles within 2 business days, you can do it next day in almost all freely tradable currencies and, with certain cutoff time parameters, you can do it same day today. It's just it's not the typical handling of the payment. Generally, a spot payment gives the treasury department within an organization and the banks that they're dealing time to process the transaction. And just because you can do real-time payments doesn't mean that all the staffing and people are available to go and do that. A lot of corporations still process in batches, as do banks, and I think the FX market here just as a standard hasn't caught up, but I do expect that to change.

**Tom McLaughlin:**

And the one thing I'll throw out there, Paul, too, as you mentioned, the ability to do some transactions on a same-day basis. To Katie's point on best practices, it's one thing if it's a smaller payment. But if there is a very specific need, large dollar amounts, you should certainly advise your FX representative as early on as possible because there's certain to be payment delays if you miss a cutoff and things like that.

**Paul Toth:**

Yes, that's a good point, Tom, and it's especially true today with recent changes that we've seen in the AML BSA with the anti-money laundering regulations that banks have to deal with, where as a part of Know Your Customer, banks are looking at what is the standard type of transaction that people are doing? And as a result, payments that are outside that standard may actually be held up until it's determined whether that's an appropriate transaction or not. So it becomes important to communicate about this.

So we're just about out of time, but I'd like to thank Katie and Tom for a great presentation today and for providing insight and perspective on currency considerations when repatriating foreign earnings. We would also like to thank everyone who attended today's webinar for their time and attention.

A PDF of today's presentation as well as the CTP certificate credit is now available for you to download from the green Resource List file folder widget in the lower center portion of your screen. You will also see a link to a short survey on your screen. Your feedback is important to us, and we greatly appreciate your thoughts on today's session and presenters.

This concludes our presentation today. Thanks again for joining us.

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CIB ENT PDF 0618-0129-861004