ACT LEADING TREASURY PROFESSIONALS

GIVING DIRECTION

BRIEFING NOTE:

BREXIT 2016

A POST-REFERENDUM CHECKLIST FOR TREASURERS

AUGUST 2016

ACT LEADING TREASURY PROFESSIONALS

Briefing note

Brexit 2016 – a post-referendum checklist for treasurers

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The Association of Corporate Treasurers
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Additional ACT Brexit documents and useful third party resources, including the ACT's Briefing Note: Brexit 2016 (published March 2016) can be found at: https://www.treasurers.org/brexit

For further information visit www.treasurers.org

Guidelines about our approach to policy and technical matters are available at www.treasurers.org/technical/manifesto.

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Executive summary

On June 23 2016, the people of the United Kingdom (UK) voted to leave the European Union (EU) and as a result, the UK (and to a lesser extent Europe) has entered a period of considerable uncertainty whilst the exit is negotiated.

In addition, non-Brexit related economic conditions and other global events (low interest rates; slowing growth in China and other emerging markets; and heightened levels of political risk arising for different reasons, in such diverse areas as the Middle East and USA) mean that not only the UK, but large areas of the world are entering a period of considerable uncertainty.

The objective of this briefing note is to provide a checklist of those areas corporate treasurers may wish to consider as they develop their plans for managing thorough a period of uncertainty. It has been purposely developed as a checklist of questions and considerations in order to provide a handy reference tool for members of the treasury team and more widely.

Many of the actions that the treasurer will need to take (or at least consider) will be as a result of actions taken in other parts of the organisation and it is therefore essential that the treasurer remains closely involved in all discussions to understand the effect on treasury activities of decisions taken elsewhere in the organisation.

This briefing note follows on from '[Brexit – a treasurer's checklist'] issued in March 2016, prior to the UK referendum, blogs already published on www.treasurers.org/blogs and supports materials that may be found of the ACT's Brexit web page at: https://www.treasurers.org/brexit

Background

This briefing note will not discuss the legal and political processes that will take place in order to achieve Brexit as these are extensively covered elsewhere in the press.

This note (like the previous Brexit 2016 briefing) is loosely based on the 'Treasury's role in driving Financial and Business Strategy' business briefing and the ACT Competency Framework[1] to ensure that the key areas of relevance to treasurers are identified.

[1] The ACT Competency Framework includes Business skills (such as planning and project management) and Behavioural skills (such as influencing and communication) which are vital to a treasurer, particularly when managing through a period of uncertainty but which will not be covered in detail in this technical briefing. Further support for members to develop business and behavioural skills can be found at: https://www.treasurers.org/membership/careerhub

A post-referendum checklist for treasurers

Impact on the company

Strategy

Checklist:

1. What is the likely impact of Brexit on your organisation?
    a. Will your business strategy alter?
    b. Will all or only part of the organisation be affected?
    c. Are there additional costs of doing business?
2. What is the likely impact of Brexit on your competitors?
    a. Does it materially alter the commercial environment?
    b. Will your industry reorganise to react to Brexit: amalgamate; fragment; offshore?
3. How will any changes in the organisation's strategic plan impact the balance sheet?

Considerations:

- Treasurers need to be involved in strategic planning to understand how funding, risk management and cash management strategies will need to change as a result of changes in the organisation's strategy (e.g. changes in location of production)
- Operational and financial flexibility become much more important in a period of rapid change
- Different parts of the organisation (by line of business or geography) may be affected differently and so a one size fits all policy will not be appropriate
- If there is a downturn, business plans relying on funding from retained earnings or significant disposals may be vulnerable
- Changes in strategy may result in previously approved investment plans being revisited which will impact funding requirements
- Changes to strategy will impact the balance sheet and future funding plans.

Legal structure

Checklist:

4. Is the corporate legal structure still fit for purpose?
    a. Where are legal entities domiciled (UK, within EU) and why?

Considerations:

- Corporate structure may be impacted as a result of changes in corporate strategy
    - Legal, tax, or operational costs may increase
    - The ability to move funds, risk of trapped cash etc. should be understood and communicated
- If new (trading) companies have to be established, new or altered banking arrangements may be implemented and KYC requirements must be met
- If your business' location(s) were specifically chosen to facilitate cross-border trade, this may no longer 'work'.

Credit rating

Checklist:

5. Will any sovereign rating downgrade filter through to your own credit rating, and if so will that impact pricing etc.?

Considerations:

- One of the consequences of the referendum will be the review of the sovereign credit rating of the UK. UK companies will need to monitor the effect on their own credit rating of any changes to the UK's credit rating.

Impact on treasury activities

Funding

Checklist:

6. Will sources of finance need to change?
   a. Will the organisation still have access to current markets (e.g. EIB funding, public bond or bank market)?
   b. Will the bank market shrink as non UK participants withdraw, and EU Banking Union accelerates?
7. Do you know who your lenders are (not just the banks but also the wider debt investor base) and how their investment decisions are made?
8. Does the organisation's funding strategy need to be revised as a result of strategic change?

Considerations:

- The proportions of medium term and long term debt, committed and uncommitted finance and the underlying currency of the debt may need to be adjusted
- Pricing in many financial markets is at historic lows; the price of debt may influence the choice of market but the UK and European markets may diverge as a result of Brexit.

Hedging

Checklist:

9. How do you address the increased volatility in financial markets, such as the FX market?
10. What will any change in interest rates mean to the organisation?
11. Does commodity pricing impact the business?

Considerations:

- The relatively volatile FX markets are not only a factor of Brexit but of broader political and economic conditions, however, they should still be addressed
- There may be a trade-off between the cost of hedging and the protection of operating margin
- The low interest rate environment makes funding attractive but earning a return on surplus funds will be challenging
- Will negative interest rates undo the effect of hedges (e.g. interest rate swaps)?

Bank relationships

Checklist:

12. Given any changes to corporate strategy, will existing bank relationships still be appropriate?
13. What is the impact on the bank group of changes to banks' strategic plans and priorities?
    a. Will your banks continue to meet your investment criteria?
    b. Will your current banks remain active in countries where you operate[2]?

Considerations:

- Businesses may find the choice of banks available to them in particular jurisdictions alters as a result of Brexit negotiations
- Treasurers will need to ensure their relationship managers appreciate the need for early advice if any bank is withdrawing from a particular line of business or seek to have it transferred to a different entity in its group
- Differences in the form of banking separation within and outside the EU, and further Eurozone banking union may complicate cash management (e.g. pooling of funds across entities and banks)
- Many corporates use credit ratings as a means of selecting counterparties and applying exposure limits to them as part of their investment policy. Brexit (and the implementation of bank 'ring-fencing' solutions (Vickers, Volker, and Liikanen)) may result in credit ratings being applied to existing counterparties that take them outside existing investment criteria.

Trade finance

Checklist:

14. What is the likely outcome of Brexit on your suppliers?
    a. To what extent is it desirable /necessary to support them (e.g. through the provision of supplier finance)?
    b. Is there a supplier which would cause you disruption if it failed?
15. Do you rely on trade credits to import/export?

Considerations:

- There may be a commercial benefit from providing credit support to key suppliers
- Relationship banks may withdraw from markets due to domestication. You may need to rely on agent banks to complete trade credit transactions which will increase cost and duplicate KYC processes.

[2] Domestication: the withdrawal of banks to within the geographic border of their central bank. A symptom of banks' reliance on central bank support post GFC.

Working capital management

Checklist:

16. How will working capital be impacted?

Considerations:

- Consider all elements of the working capital cycle:
  - Suppliers
  - Customers
  - Inventories
  - Cash management float
- The length of the working capital cycle may be affected by Brexit negotiations and in particular, any imposition of duties and border controls
- Treasury should liaise with procurement teams to understand if contracts with non-domestic suppliers and customers are capable of amendment to accommodate changes or whether they could be terminated if these changes rendered them uneconomic
- Increased levels of working capital and the need for increased flexibility to manage change may require larger working capital bank facilities.

Counterparty risk

Checklist:

17. How will the risk profile of counterparties (financial and non-financial) change?

Considerations:

- Consider requesting credit support agreements or taking collateral from counterparties
- Think about the extent to which your offset arrangements on your cash pooling would stand up in the event of a bank insolvency. Moving to a zero balancing arrangement may be safer than notional offsetting.

Treasury operations

Checklist:

18. How will any changes impact on the structure of the treasury function?
    a. Will the location of any treasury company or your Shared Service Centres (which may be located regionally e.g. in the Netherlands or Central Europe) still be optimal?
    b. Will the skill set/roles within treasury remain appropriate?
19. Will your approach to certain activities need to change?
20. Do treasury policies and procedures need to be updated?
    a. Are you compliant with all the policies?
    b. Does your Board need to reconsider the powers delegated to treasury?

Considerations:

- Treasury needs to ensure that they are involved in strategic decisions to:
  - understand the impact on the treasury team
  - identify the consequences that any change of strategy will have on treasury operations and priorities

- Likely impact on treasury structure and terms of reference
  - Size, location, role
  - Skills within the treasury team – are they still relevant and complete?
- Access to certain types of financial markets and products may change which will need to be reflected in policies and procedures
- Changes in bank regulation may impact on operations
  - EBA guidelines in the EU may render current pooling practices uneconomical or impractical
  - Changes to MMF legislation in USA and EU may require changes both to treasury policies and external practices.

Other considerations

Communication and disclosure

Checklist:

21. How will the referendum impact reporting and disclosure requirements?
22. Do you have strong relationships with your bank group, rating agencies and debt investors?

Considerations:

- Changes in business strategy will flow through to business plans, forecast and funding plans and ultimately to Going Concern statements
- Ensure that the risk register is updated as things evolve through the Brexit process
  - Consider frequency, level of detail and the circulation of risk reports - they should not be treasury specific
- During periods of uncertainty, close relationships enable flexibility and the ability to respond quickly to events
- Demonstrating compliance to policies is particularly important to stakeholders through a period of rapid change.

THE ACT WELCOMES COMMENTS ON THIS NOTE

Please send your comments to technical@treasurers.org

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