HOT TOPICS IN 2013

Treasurers often ask me about the ACT's hot topics, which caused me to reflect on our likely agenda for 2013. I predict collateral management (through clearing houses or bilateral); the reporting of derivatives to trade repositories; the impact of banking reforms on corporates; and alternative sources of funding to occupy a lot of my time. One of my 2012 challenges was to draft a briefing note on repos, which I cover below.

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{ IN DEPTH }

LIFTING THE LID ON RISK CULTURE

The ACT has given its support to two guidance documents on risk culture, published by the Institute of Risk Management (IRM). Endorsing the document, ACT chief executive Colin Tyler wrote: "Treasurers know that risk management goes beyond risk policies and rules – it is also driven by values, beliefs and attitudes of the individuals and their organisations. IRM members, like ACT members, realise that professional standards, an ethical code and good training will contribute to a good risk culture. The relationships analysed in the IRM Risk Culture Framework show that the right individual can, and does, make a real difference."

While risk management rules and frameworks have evolved significantly in recent times, they alone are not sufficient to make a tangible difference to an organisation's success or failure since rules can be broken, either inadvertently or intentionally. The papers describe the 'missing link' as the risk culture – understanding how to successfully balance risk and reward in decision-making.

Risk culture can be defined as the behaviour of individuals and groups within an organisation that determines the way they act on the risks the organisation confronts and what risks it takes. These behaviours are shaped by the underlying values, beliefs and attitudes of individuals within the organisation. Individuals are themselves influenced by the prevailing culture in an organisation, resulting in a vicious circle or 'cultural cycle'.

The IRM papers note that "every organisation has a risk culture (or indeed cultures); the question is whether that culture is effectively supporting or undermining the longer-term success of the organisation". An organisation's risk culture is important because it affects its capability to take strategic risk decisions and deliver on performance promises. An inappropriate risk culture will:

- inadvertently allow activities that are either at odds with stated policies and procedures, or operate completely outside these policies;
- result in the rest of the organisation ignoring, condoning or not seeing what is going on; and
- hamper the achievement of strategic, tactical and operational goals.

The IRM papers cited two recent examples that resulted in serious reputational and financial damage: the phone-hacking scandal at Newscorp and the misstatement of the London Interbank Offered Rate (Libor) at Barclays.

Corporate governance increasingly places a level of responsibility on the board to set, communicate and enforce a risk culture that aligns with the strategy and objectives of the business. The IRM has developed a Risk Culture Aspects Model, which identifies eight aspects of risk culture that can be analysed to assess the 'health' of an organisation's risk culture. These eight indicators are grouped into four key themes: tone at the top; governance; competency; and decision-making. Diagnosis is through a simple questionnaire or structured interview techniques. Identified strengths and weaknesses are then followed by a gap analysis.

Further details on this and other risk culture models, plus case studies and survey results, can be found at www.treasurers.org/system/files/IRM_riskculture_full_Oct12.pdf and the IRM's risk culture guidance document for boards can be found at www.theirm.org/documents/Risk_Culture_A5_WEB15_Oct_2012.pdf

YOUR SHOUT

How would you be affected if the British Bankers' Association ceased publishing all Libors for AUD, CAD, DKK, NZD and SEK, and for remaining currencies, the periods of four-, five-, seven-, eight-, 10- and 11-month tenors? Email: modonovan@treasurers.org or mprice@treasurers.org

{ INTERNATIONAL }

IOSCO AND MMF REFORMS

The International Organization of Securities Commissions (IOSCO) has published its final report, *Policy Recommendations for Money Market Funds* (MMFs). This review forms part of the efforts of the G20 and Financial Stability Board to strengthen the oversight and regulation of the shadow banking system following the September 2008 run on some MMFs.

The implementation of the report's recommendations may vary from jurisdiction to jurisdiction, but IOSCO outlines 15 proposals, including:

- Converting constant net asset value (CNAV) to variable net asset value (VNAV) where workable. If that's not possible, developing additional safeguards to reinforce CNAV MMFs' resilience and ability to face significant redemptions;
- Restricting the type of assets funds can invest in. Specifically "funds should not take direct or indirect exposures to equities or commodities";
- Defining a minimum level of liquid assets that funds should hold;
- Performing regular stress tests;
- Disclosing to investors how funds value their investments and how they would act in times of financial stress; and
- Using tools such as temporary suspensions in order to manage a run on the fund.

IOSCO states that implementation of some recommendations may need to be phased to avoid disruptive impacts on the industry and the functioning of the financial system at large.

The ACT responded to the May 2012 IOSCO consultation on MMF reform, saying that the CNAV label can be misleading since maintaining par value is not guaranteed. Nonetheless, converting CNAV funds to VNAV would cause many companies to cease using them. The ACT's full response is at www.treasurers.org/node/7957

View the following technical updates and policy submissions at www.treasurers.org/technical

Practical steps to investing in repos briefing note

Margin requirements for non-centrally cleared derivatives

ACT response to setting the strategy for UK payments

{ WATCH THIS SPACE }

REPOs: AN ALTERNATIVE INVESTMENT

The ACT has published a briefing note on the practical steps to investing in repurchase agreements (repos). Repos are typically used by banks and building societies to borrow money on a short-term basis in the absence of unsecured money market funding, which has almost dried up following the global financial crisis. Corporates, on the other hand, continue to conserve their cash and face the challenge of diversifying their investment portfolio from a list of financial counterparties with dwindling credit ratings. Even though repos provide additional protection to the investor through ownership of collateral, they are not widely used by non-financial companies.

The ACT believes one reason may be a lack of practical knowledge in the market, meaning the operational processes remain mysterious to treasurers and CFOs. Our repo briefing note aims to fill some of these gaps with a high-level comparison of repos against five short-term liquid investment products; a comparison of the key characteristics of tri-party and bilateral repos; steps that need to be taken before investing in repos; and an overview of transaction flows.

See the briefing note at www.treasurers.org/technical

{ TECHNICAL ROUND-UP }

REPORTING AND RENMINBI

Two Financial Reporting Lab (Lab) project reports on 'Debt terms and maturity tables' and 'Operating and investing cash flows' have been released by the Financial Reporting Council (FRC). The Lab worked with large companies and investment organisations to explore reporting practices and what investors found useful. For companies with significant net debt, investors would like detailed terms of debt by obligation in addition to the overall debt profile. They also want contractual maturity amounts reconciled to debt on the balance sheet. See http://tinyurl.com/d27olll

A renminbi resource pack has been published by the City of London as part of the initiative on London as a centre for renminbi business. Booklets covering renminbi corporate and treasury services in London, FAQs and case studies are available at www.cityoflondon.gov.uk/renminbi

The EU Council has issued its interim report on the process towards deeper economic and monetary union. The report emphasises that an integrated financial framework is needed to achieve genuine union, including a single supervisory authority, a common resolution framework and national deposit guarantee schemes built on common standards. A final report will follow in December 2012.

The Internal Revenue Service is extending the grandfathering protection for non-US arrangements caught under the Foreign Account Tax Compliance Act (FATCA). The protection is extended from 1 January 2013 to six months after the regulations are finalised, estimated to be July 2013 at the earliest. FATCA imposes US withholding taxes and significant compliance obligations on financial institutions such as banks and insurance companies.

The FRC has published a discussion paper, *Thinking about financial reporting disclosures in a broader context*. This sets out a road map for a disclosure framework based on these questions: What information do users need? Where should disclosures be located? When should a disclosure be provided? How should disclosures be communicated? The consultation period closes on 31 January 2013.