ASSESS, PLAN, **IMPLEMENT**

SUCCESSIVE ROUNDS OF REGULATORY REFORM HAVE SUBSTANTIALLY ADDED TO THE WORKLOAD OF TREASURERS AND THEIR TEAMS. SARAH RUNDELL LOOKS AT THE PLANNING IMPLICATIONS AND THE CURRENT REGULATORY TIMETABLE

Corporate treasurers have never had to navigate quite as much regulation as they have in recent years. Since the financial crisis, waves of reform have steadily changed the way financial markets and banks are regulated. The central idea has been to rein in the risks within the banking sector and ensure that no bank failure could pose a systemic threat again.

The approach has led to policies to strengthen banks' balance sheets, reduce contagion in financial services, and separate banks' retail and investment banking divisions. And every reform has had significant trickle-down ramifications for banks' corporate customers, who have had to juggle their cash and liquidity requirements.

CAPITAL ADEQUACY

The EU's Capital Requirements Directive IV (CRD IV) applies to banks and investment firms across the continent, aiming to ensure they meet Basel III capital adequacy requirements. Two of the more important consequences for corporate treasuries are the directive's impact on the amount banks are prepared to lend to their corporate customers and banks' appetite for taking short-dated deposits.

Under CRD IV, the amount of capital that banks must hold against credit risk has doubled compared with levels prior to the financial crisis. It means banks are reassessing their product range. "Banks have reduced the size of their balance sheet and are thinking about what products they want going forward, and who they are prepared to deal with in the future," says Michelle Price, associate policy & technical director at the ACT. "The requirements mean that banks are repricing their business. It means some products are more expensive – but some are also more attractive," notes Paul Wilde, treasurer at Shawbrook Bank.

In the second strand to the regulation, CRD IV is causing banks to re-evaluate their willingness to take on short-dated deposits. While some banks are still happy to accept companies' short-term cash surpluses, others increasingly only accept them as a gesture of goodwill and as part of an ongoing relationship with the company. "The new liquidity ratios mean many banks aren't really interested in short-term deposits," says Wilde.

MONEY MARKET FUNDS

Treasurers have found alternatives for their short-dated cash. But now regulation is affecting decision-making here, too. Money market fund (MMF) reform in Europe is ushering in changes to these popular investment vehicles, which typically come with a AAA credit rating, liquidity diversification and better returns than low-yielding bank deposits.

Full implementation of MMF reforms won't take place until February next year, but treasurers need to start preparing for the replacement of constant net asset value (CNAV) funds with two new categories: the Public Debt CNAV fund and the low-volatility NAV (LVNAV) fund. According to

Perhaps the biggest regulatory change treasury teams need to prepare for this year is the ring-fencing of UK banks

research from rating agency Moody's, LVNAV MMFs are likely to attract most of the assets currently invested in prime CNAV MMFs.

Switching to the new funds will require an onboarding process, amending investment policies and working with auditors to navigate the changed accounting treatment, explains Price. "Treasurers need to look at their policies and establish if they can invest in these kinds of funds and still account for MMF funds as Cash and Cash Equivalents. Asset managers will do most of the legwork converting funds, but corporates need to understand their investment policies." A recent survey by JPMorgan found that 44% of corporate respondents needed more time and information before making decisions about how they will use MMF structures under the new rules. "But teams still have time to prepare," reassures Price.

DERIVATIVES

The impact of European Market Infrastructure Regulation (EMIR) on banks' derivative use has given treasury teams another regulatory headache. The rules are designed to reduce the risks posed to financial systems from derivatives. The principle requirements include central clearing and margining of OTC derivatives for some, as well as reporting all transactions to a trade repository for all. It has required the treasury community to deliver complex information, in costly processes. In 2015, the European Association of Corporate Treasurers estimated that, combined, European companies spent between €2.4bn and €4.6bn annually to remain compliant with EMIR.

Potential relief came in the middle of last year, when the European Commission proposed new measures to both streamline and alleviate the reporting burden on non-financial corporates that use derivatives. There have also been positive elements to the regulations, notes Wilde. He believes that requirement for banks to collateralise their derivative exposures can help improve risk in a positive way. "EMIR is a good thing for banks and treasurers, because instead of having collateral pools with different banks, companies now have one collateral pool with a clearing house. It is about realigning back-office operations."

RING-FENCING

Perhaps the biggest regulatory change treasury teams need to prepare for this year is the ring-fencing of UK banks. This regulation, which only affects the largest UK banks, will see banks separate their investment and retail operations. Companies need to consider which part of the split bank is now meeting their banking needs, and ask several important questions, says Price. "Is it a riskier bank than before? How is the split affecting the bank's credit rating? What exposures is the new bank prepared to run?" she asks. Ring-fencing also involves an administrative burden, as corporates may need to physically change accounts and complete due diligence.

ACCOUNTING

IFRS 9 ushers in new rules in the accounting of financial instruments, effective for accounting periods beginning on, or after, January 2018. It has key implications around hedge accounting, and the standard also penalises banks with exposure to riskier asset classes, which could have implications for treasury in smaller companies, warns Ian Tyler, a senior adviser in Alvarez & Marsal's financial advisory team.

"This could have an impact on banks' appetite to lend to SMEs," he says, adding: "The regulator is modelling and working with banks on stress testing, but it isn't clear how the increased provisions will be treated for regulatory capital purposes."

This is an unknown that Chris Raftopoulos, a director at PwC, is also flagging to corporate clients in the consultancy's treasury advisory. "The main challenge impacting corporates seems to be implementation of the new impairment rules. These require

an expected credit-loss provision to be set aside," he says.

Treasury departments are more positive about IFRS 9's impact on hedge accounting. "Regarding hedge-accounting rules, the journey has been positive rather than negative," says Tyler. It has led to a broader range of hedging strategies qualifying as hedge instruments and hedge items. That means more flexibility in how companies manage risk, and it addresses some of the frustrations of hedge accounting under the predecessor, IAS 39. The new rules will likely see companies opting to hedge more of their FX, interest rate and commodity risks, better protecting financial assets and business value.

MARKET ABUSE REGIME

Treasury teams also need to adjust to the impact of the market abuse regime (MAR) and its duty to disclose inside information. Applicable since 2016, treasury would be wrong to assume this legislation is just aimed at banks, warns Price, who believes that many treasurers are unprepared. "We've been pushing the Financial Conduct Authority to ensure MAR is better understood among corporates and are trying to get the word out there," she says.

MAR will affect how corporates monitor and account for the sensitive, non-public information that feeds into investor meetings or roadshows ahead of bond and share issues. Housekeeping will mean corporations have to list employees that have access to inside information and maintain a register of consultants and advisers who also have that information. "Companies need to record and document processes and be much more aware," says Price.

CONCLUSION

However, the pace of regulatory change triggered by the need for banking reform is finally starting to slow. Current changes often involve amendments to existing regulation, rather than new regulation per se. That doesn't mean new challenges aren't on the horizon. For example, US tax reforms will see companies repatriate money to the US, potentially impacting liquidity. Cybersecurity and technological advancement are two other challenges. It means staying ahead of future changes and managing the impact of regulation must remain a priority.

Above all, corporate treasurers need to undertake an impact assessment for those reforms already on the table if they are to successfully plan their response, mitigate effects where possible and reassure the board and their internal audit functions that all is well within treasury.

Sarah Rundell is a freelance journalist specialising in treasury and investment issues