THE IN-OFFICE SCHOOL
Why teaching skills are essential for treasurers delivering change

BORROWER GUIDELINES
The ACT's overview of the LMA's Investment Grade Agreements

SECURITISATION FOR SMEs
Evolving peer-to-peer financing is addressing the funding gap

The Treasurer

THE MAGAZINE OF THE ASSOCIATION OF CORPORATE TREASURERS

MAY 2017

"Networking is an important part of the job"

Mona Lockett, head of treasury at Webcor

PLUS

IN SEARCH OF VALUE
Technology that treasurers prize and what they want to see next

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The Treasurer May 2017 The Magazine of The Association of Corporate Treasurers www.treasurers.org/thetreasurer

ACT

LEADING TREASURY PROFESSIONALS

Editor's letter

At this time of year, we look forward to the ACT's cornerstone event, the Annual Conference 2017, which gives members the opportunity both to engage with each other and with the big issues of the day: the pace of global change, economic headwinds and trends in business strategy.

This year, group treasurers speaking at the conference include Paul Hedley of Rio Tinto, Fiona Rose of Burberry and Rick Martin of LNG logistics company GasLog, which won UK Treasury Team of the Year in *The Treasurer*'s Deals of the Year Awards in February. Also speaking at the conference are Lord Michael Dobbs, politician and bestselling author of the *House of Cards* trilogy, and forecaster Leo Johnson. On day two, a question time session will be hosted by broadcaster Huw Edwards.

In this issue of *The Treasurer*, we look at technology. Survey after survey present us with pictures of an automated future, one where our working lives are much less consumed with mundane tasks and more concerned with strategic and business advisory ones, ones that add value and, increasingly, corporates are focusing on their digital capabilities.

Of course, to the extent that the surveys come from technology providers, these outcomes are contingent on technology investment, ie not so much added value as added cost – at least to start with. And, as we know, the connection between IT investment and productivity enhancement is sometimes far from straightforward. The gulf between promise and delivery can be frustratingly wide at times.

We asked six treasurers about the progress they've seen on the back of technology and, crucially, what they would like to see in the future. The good news is the gains on some fronts have been significant and our interviewees are enthused by the outcomes they've seen. There is no doubt that gaps still exist in terms of progress towards a fully integrated, low-friction digital treasury infrastructure, however. Turn to page 22 for Lesley Meall's feature on the technology story so far and a look at treasurers' technology aspirations and wishes.

Whether through technological innovation or regulatory evolution, treasurers often face change management issues. A significant part of handling those relies on an ability to educate the treasury team. So whose job is that and just how is it most effectively carried out? Andrew Burgess argues on page 26 that treasurers can be effective teachers and explains how to put together a teaching plan.

Elsewhere in the issue (page 18), we talk to Mona Lockett, head of treasury at food group Webcor, about operating in the Middle East and Africa, implementing a TMS and centralising treasury.

I hope you enjoy the issue and look forward to seeing many of you in Manchester.

editor@treasurers.org
Follow us on Twitter @thetreasurermag

THIS MONTH'S CONTRIBUTORS

Peter Goshawk is the incoming president of the ACT, chair of Barclays Pension Fund and a treasurer of long-standing. He has held numerous non-executive director roles in his career, and writes on the changing status of treasurers on **page 17**

Andrew Burgess is an experienced treasury professional working for GE Alstom near Zurich. He is also the ACT's regional organiser for Switzerland, and has written several articles for *The Treasurer*. His latest piece, on how to pass on treasury wisdom to others, is on **page 26**

Ben Walters is deputy treasurer at Compass, having recently spent four months performing the group treasurer's role following the retirement of the former group treasurer. Part two of his three-part series on corporate finance can be found on **page 36**

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Members of the Events and Publishing Forum (EPF) provide the ACT with strategic and consultative support **a)** developing relevant issues with a medium-term horizon; **b)** apprising the ACT team of competitor developments; **c)** broadening the speaker and contributor network; and **d)** underpinning the ACT's overall aims (in education, membership growth, international development). If you are interested in participating in the EPF, please contact dmurphy@treasurers.org

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What do you think of this issue of *The Treasurer*? Please write to **editor@treasurers.org** or tweet **@thetreasurermag**

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Mona Lockett, head of treasury, Webcor Group

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Agenda

For the latest news and comment in the treasury world, follow us on Twitter **@thetreasurermag**

{ REGULATION }

POLICYMAKERS CLOSE TO FINALISING BENCHMARK REFORMS

Key initiatives to review benchmarks and standards for bank and interbank rates are coming to fruition.

The European Securities and Markets Authority (ESMA) has published its final report containing the draft regulations and implementing technical standards under the Benchmarks Regulation.

The objective of these rules is to ensure the accuracy and integrity of benchmarks across the EU by setting out the behaviours and standards expected of administrators and contributors.

The European Commission has three months (from 30 March) to approve or reject the benchmarks, with the regulation expected to come into force on 1 January 2018.

Over the past three years, the European Money Markets Institute (EMMI) has been in the process of reforming the Euribor benchmark. The institute has recently published a paper setting out the legal grounds for the proposed reforms.

The Bank of England has also published its feedback on proposed reforms to the Sterling Overnight Index Average rate, while the ICE (Intercontinental Exchange) Benchmark Administration has published feedback on the evolution of ICE Libor.

The publication time of ICE Libor has moved from 11:45 to 11:55 London time to give banks enough time to make their pre-submission checks. More detail on the final and near-final reforms can be found on the EMMI, Bank of England and ICE websites.

{ CONTEXT OF TREASURY }

Banks to step up cybersecurity efforts

Financial services firms expect 2017 to be a watershed year in terms of regulatory scrutiny of online activities. Survey data from corporate finance advisory firm Duff & Phelps found respondents expect cyber- and data-security issues to be a top priority for regulators.

Eighty-six per cent of financial services firms intend to increase the time and resources devoted to cybersecurity, the survey found. Two-thirds said they expected cybersecurity to be a priority for regulators this year, while 39% said they also believe regulators will pay more attention to financial crime and KYC compliance issues.

The UK government unveiled a new cybersecurity strategy in November last year, devoting £1.9bn over five years and setting up a National Cyber Security Centre. The UK has seen high-profile attacks over the past year, including the theft of funds from 20,000 personal accounts at Tesco Bank, and the theft of personal data from Three. Cyberattacks in Europe include the loss of €40m at electrical component manufacturer Leoni AG.

Jason Elmer, managing director, compliance and regulatory consulting at Duff & Phelps, said investor and regulator concerns were likely to combine to increase the focus on cybersecurity and innovation. "In the wake of high-profile cyberattacks, many firms are anticipating clearer and more punitive cybersecurity regulation to be implemented. Firms are proactively looking to strengthen cyber defences as a result, and this is an opportunity for regulators to collaborate with financial institutions to form new rules," he said.

"We see a global economy that has a spring in its step, benefiting from sound policy choices in many countries in recent years. At the same time, there are clear downside risks: political uncertainty, including in Europe; the sword of protectionism hanging over global trade; and tighter global financial conditions."

Christine Lagarde, head of the IMF (pictured above), confirms an upswing in global growth, but warns against limits on free trade.

SOURCE: *THE NEW YORK TIMES*, 18 APRIL 2017

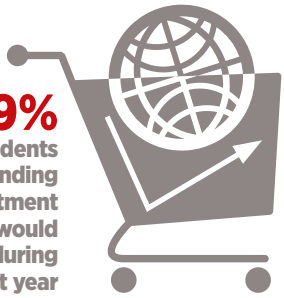
"It is essential that national regulators do not compete on regulatory and supervisory treatment. It is high time to strengthen the instruments to support supervisory consistency across the EU."

Steven Maijoor, chairman of the European Securities and Markets Authority, argues the case for a stronger mandate to prevent a race to the bottom in regulatory frameworks.

SOURCE: *THE FINANCIAL TIMES*, 11 APRIL 2017

WIKIMEDIA

{ FINDINGS FROM THE 2017 AMEX *GLOBAL BUSINESS & SPENDING OUTLOOK* }



99%
of respondents said spending and investment worldwide would increase during the next year

48%
said they would increase headcount

67%
said they would be spending more on customer service

81%
said that, in their business, the CFO has more influence over strategic decision-making than the CEO

51%
said they would increase spend on technology infrastructure

{ CONTEXT OF TREASURY }

A THIRD OF UK BANKS CANCEL GDPR PREPARATIONS

A third of businesses in the UK banking sector have halted preparations to comply with the EU General Data Protection Regulation (GDPR), on the mistaken basis it will not apply after Brexit.

In a survey of IT decision-makers in the banking sector, information-management firm Crown Records Management found 33% have cancelled all preparations for GDPR compliance, while 5% had not begun preparation. More than half (55%) believed the regulation would not apply to businesses in the UK following the vote to leave the EU.

The regulation, which harmonises data-protection regimes across the EU and has been ratified in the UK, will come into force in May 2018, almost certainly prior to Britain completing its exit arrangements. The regulations introduce significant fines – up to €20m or 4% of global turnover – for businesses that suffer data breaches.

Crown's survey found more positive initiatives afoot, too. Eighty per cent of businesses with more than 100 employees have appointed a data-protection officer, in line with GDPR requirements, and 38% have introduced staff training.

However, director of information management John Culkin said it was important that firms don't delay preparations further, since the regulations will apply to all businesses that handle data relating to European citizens. "The reality is we are likely to continue to see stringent data protection in an independent UK rather than a watered-down version," he said.

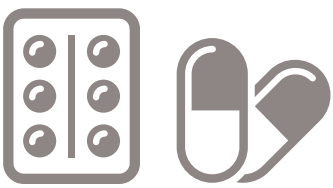
What do you say?
Tweet us
@thetreasurermag

"The challenge for policymakers is to ensure that fintech develops in a way that maximises the opportunities and minimises the risks for society. We are ideally positioned to realise fintech's promise in the UK."

Mark Carney, speaking at a UK government-sponsored event, argued fintech could promote financial stability and boost growth.

SOURCE: *CITY A.M.*, 12 APRIL 2017

€16,000
The amount France's Institute for Space Medicine and Physiology will pay volunteers to spend 60 days lying prone, exploring the effects of microgravity



€5.3bn
The amount Bain Capital and Cinven paid for German drugmaker Stada, the biggest private equity purchase of a European company in recent years

$100m
The amount paid by the US Securities and Exchange Commission to whistle-blowers since 2012

75 million
Germany's projected population by 2050, down from 82 million

31%
The projected decline in Japan's population by 2065, down to 88 million from today's 127 million

28%
The percentage of businesses reporting a decline in job applications from EU citizens since last June, according to recruitment firm Reed

{ AROUND THE WORLD IN 30 DAYS }

ITALY CUTS, DODD-FRANK, UKRAINE GOVERNOR RESIGNS

An extra €3.4bn of budget cuts is on the way in Italy

SHUTTERSTOCK

Italy approves budget cuts

In April, the Italian government approved €3.4bn in extra budget cuts in an effort to meet EU demands. The centre-left government, led by Paolo Gentiloni, approved the extra measures to reduce the Italian government deficit in a cabinet meeting that also approved the country's annual economic planning and confirmed an increase in forecast growth from 0.9% to 1.1% in 2018. Italy's finance minister, Pier Carlo Padoan, said the extra cuts would come from more efficient tax collection and policing of tax evasion, along with spending reductions.

Dodd-Frank replacement unveiled

In an ambitious plan to undo the US Dodd-Frank financial reform law, the head of the US House of Representatives banking panel has released a second draft of a replacement act.

Jeb Hensarling, chair of the House Financial Services Committee, said the new bill will end the Dodd-Frank "mistake", while holding Wall Street and Washington accountable, and enabling the US banking and commercial sectors to perform better. Republicans including President Trump believe Dodd-Frank, which has not been fully enacted, is unduly burdensome on banks and businesses, and restricts lending.

Ukraine central bank's governor resigns

Valeria Gontareva stepped down as governor of the Ukrainian central bank in April after nearly three years at the helm.

Gontareva said that her resignation did not herald changes in central bank policy or other changes to the bank's governing board.

She has been credited with stabilising the economy in Ukraine in the wake of Russia's annexation of Crimea in 2014.

Valeria Gontareva

WIKIMEDIA

{ BREXIT }

BANKS MAY FACE SIX-MONTH LICENCE WAIT

UK-based banks relocating to Europe following Brexit may need to wait six months for a licence, the European Central Bank (ECB) has said.

Applications to operate in the eurozone must be submitted to the ECB, via the bank's national supervisors, for assessment by the ECB's supervisory board and ratification by its governing council. The time taken to process applications will depend on their complexity, completeness and quality, the ECB has said, but all applications must be resolved in 12 months.

The criteria for attaining a licence include appropriate governance procedures, fit and proper management bodies, and suitable levels of capital, liquidity and solvency.

The ECB has said it remains neutral regarding the location chosen by banks applying to operate in the euro area. "All significant institutions are supervised directly by the ECB, using a single set of supervisory standards, irrespective of the country in which they operate," it said.

The loss of the UK's passport to operate across the single market is estimated to affect around 40 UK-based banking groups.

Meanwhile, the Bank of England has asked all banks with cross-border activity to set out their contingency plans for the period following Brexit.

THE STATS

{ FINDINGS FROM THE DELOITTE CFO SURVEY Q1 2017 }

30% – proportion expecting Brexit to cause them to reduce their level of hiring, down from 66% immediately following the referendum last year

26% – amount expecting it to hit investment, down from 58% over the same period

11% – those expecting M&A activity to lower as a result of Brexit

60% – proportion still expecting a worsening in economic conditions as a result

42% – amount that rated reducing costs as a strong priority for their business

MAKING THE NEWS

More stringent UK stress tests
The UK's central bank showed its hand on stress tests for the nation's banking groups in March when it announced that banks would be assessed on their longer-term risk, including their potential resilience to the UK's departure from the EU.

The UK's seven largest banks will go through a test designed to demonstrate how they would perform in the face of a severe economic shock. The additional test will be applied at the end of 2017, and annually thereafter.

New Zimbabwe borrowing rules
The government in Zimbabwe has proposed laws that will enable borrowers to use assets such as cars and livestock as collateral for bank loans in a move aimed at freeing up credit and promoting financial inclusion. Under the proposals, borrowers would be able to register 'moveable' assets as collateral.

Commercial banks would then be required to recognise the assets as security for loans. However, bankers are reported to be concerned about the rapid depreciation of such assets.

Other African countries that accept such assets as security to back loans include Ghana, Malawi and Nigeria.

Death knell for stock exchange merger
Officials at the European Commission have given their final say in blocking the £21bn merger between the London Stock Exchange and Deutsche Börse.

On the same day that the UK government triggered Article 50, signalling the start of its Brexit negotiations, EU competition regulator Margrethe Vestager said the tie-up would create a "de facto monopoly in the crucial area of fixed income instruments".

The stock exchanges have attempted mergers on two previous occasions, in 2000 and 2005, and the latest proposals also foundered on where the merged exchange would be located.

{ ACT NEWS }

ACT EUROPE TALKS BREXIT AND TECH

At the start of last year's ACT Europe Conference in Düsseldorf, we asked delegates about Brexit, writes Peter Matza, ACT speakers' chair. Overwhelmingly, they wanted the UK to stay in the EU and didn't want anyone else to think about leaving. A lot of water has passed under quite a few bridges since then. Treasurers, though, have to be prepared to help their businesses prosper in all circumstances, and for that they need to understand the issues that matter.

Aside from political developments, the theme at this year's ACT Europe Conference in Düsseldorf quickly became apparent: process automation and technology will drive efficient and effective financial and business strategy. Delegates heard from speakers from Merck, Swiss Federal Railways and Airbus on substantial investments of time and resources in digitising treasury operations (a project with a 2025 horizon); liquidity challenges in cash and pensions in an environment of negative interest rates; and running a $100bn-plus FX risk management programme, respectively. Common to all their presentations was a need to understand business data at a fundamental level.

The ACT's Peter Matza takes questions from the floor. Inset: Rando Bruns, head of group treasury at Merck


ANDI WERNER

With a deeper appreciation of the nuts and bolts of a business, a treasurer should be able to craft a financial strategy that supports overall business development. A financial strategy panel gave clear advice that treasurers should engage with stakeholders and their boards in clear, concise and definitive terms that make plain the relationship between risk assessment and value creation. A fascinating presentation on cybercrime came to much the same conclusion – treasurers need to be clear about the risks they see, and what they can and cannot address in their roles.

Perhaps unsurprisingly, Brexit was an undercurrent. Much of the comment was of a regretful nature; it was hoped that the UK's relations with Germany and the rest of the EU will remain positive and substantive. Many expressed dissatisfaction with politicians on all sides. The ACT, meanwhile, is seen as a positive voice in the profession and appreciated by German corporates.

Overall, the message for treasury was bright, but the challenges of automation, robotics, data management, regulation and the changing nature of financial services remain formidable.

THIS MONTH

INESCAPABLE BREXIT

This month's Technical Briefing covers funding, payments reporting and, almost inevitably, a little bit of Brexit.


Michelle Price (left) and Sarah Boyce (right) are the ACT's associate policy and technical directors, and are always pleased to hear from you, whether with questions or with comments on areas of particular concern or interest to you. You can reach them at technical@treasurers.org

{ EUROPE }

Brexit is happening – hold on to your hats

Article 50 has been triggered. Now it's over to the politicians, regulators and civil service to negotiate our way through the maze.

In an interesting meeting at the end of March, one of the financial regulators set out for us the approach that it is taking, and we thought it sufficiently useful to share with you.

Phase one concerns transposition work – ie, how to onshore all the EU regulation into the UK sovereign framework. The underlying objective is to maintain alignment as far as possible, with only 'inoperable' regulation slated to change. Inoperable regulations are those that, for example, refer to EU institutions that will no longer have oversight in the UK post-2019. The regulator's guidance is that, if it is necessary to amend 'inoperable' regulation, any market impact should be minimised. Given the very ambitious timescales, (the target is to complete the work before the end of the year), any public consultation is likely to be minimal, with the justification that any amendment will not be negative for the industry affected.

Phase two is the transition to the new relationship. There are still many unknowns, but the guidance received from politicians is that fair and effective markets remain key, and nothing should be done that interrupts the flow of business into the UK.

As an aside, the thorny issue of equivalence/passporting continues, and not just for financial markets. Passporting seems to have faded away, with the focus now on ensuring equivalence.

The transposition of existing regulations into the UK jurisdiction should be relatively straightforward, enabling day one equivalence, but predicting exactly how equivalence rules will be applied (and particularly any reciprocity guidelines between the EU 27 and the UK) is, to quote one source, a 'huge, political and difficult' task.

Sounds like a pretty accurate forecast for much of the next few years.

View briefing notes, technical updates and policy submissions at www.treasurers.org/technical. Find Brexit-related resources at www.treasurers.org/brexit

For more immediate responses to events, the policy and technical team write various blogs at https://blogs.treasurers.org

Anything keeping you up at night? If you would like to be a guest contributor, please get in touch at technical@treasurers.org

{ REPORTING AND COMPLIANCE }

NEW UK PAYMENTS RULES – A LEGAL REQUIREMENT

The UK's Small Business, Enterprise and Employment Act 2015 enables the government to require large businesses to report on their payment practices and performance, and the new Reporting on Payment Practices and Performance Regulations 2017 came into effect on 6 April.

If your organisation met two out of the following three criteria on both of its last two balance sheet dates, then the reporting requirement applies: a £36m annual turnover, an £18m balance sheet total, or 250 or more employees.

There is a requirement to report twice a year, within 30 days of each half-year end – not long at an already busy time of year for the finance team.

Treasurers need to ensure that all the relevant parts of their organisation are prepared to report, and that the communications team and FD are also up to speed. There will be a real reputational risk (particularly in the early days) if your organisation is an outlier for any reason – and from analysts trying to compare across sectors.

Further details can be found on the GOV.UK website: www.gov.uk/government/uploadssystem/uploads/attachment_data/file/574312/duty-to-report-on-payment-practices-and-performance-government-response.pdf

{ CAPITAL MARKETS }

A new market for debt securities?

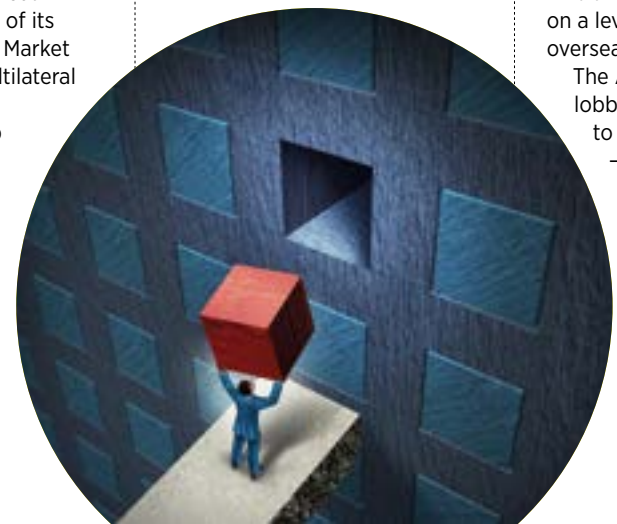
A month after the Financial Conduct Authority published a discussion paper exploring why the UK does not currently have a successful market for qualified investors and why so many fixed-income issuers pursue listings outside the UK, the London Stock Exchange (LSE) announced the launch (in Q2 2017) of its International Securities Market (ISM). This is a new multilateral trading facility (MTF) designed to fill this gap and offer issuers and investors alike greater choice and flexibility.

An MTF is a self-regulated financial trading venue established by MiFID II regulations in Europe. Article 4(15) of MiFID II describes an MTF as a multilateral system, operated by an investment firm or a market operator, that brings together multiple third-party buying and selling interests in financial instruments, in the system and in accordance with non-discretionary rules, in a way that results in a contract.

The LSE will consult formally on the ISM, but a couple of key features already announced and of particular interest to issuers include:

- **Admission standards:** as an MTF, rather than an EU-regulated market, the ISM will be outside the scope of the EU's prospectus regime, and entrants will provide admission particulars that comply with the ISM rules and are approved by the LSE.
- **Quoted eurobond exemption:** it was announced in the 2017 UK Budget that the government will introduce a new exemption from withholding tax for interest on debt traded on an MTF. This exemption will correct the current anomaly whereby some UK issuers are incentivised to list their securities overseas to benefit from a UK tax exemption. This should place the ISM on a level playing field with overseas exchanges.

The ACT was involved in lobbying the UK government to obtain this exemption – a classic example of our working in the background in the public interest. So, if there is something you think we should be aware of, please drop us a line.



{ TECHNICAL ROUND-UP }

China's financial markets

The Asia Securities Industry & Financial Markets Association has published its report *China's Capital Markets: Navigating the Road Ahead* (bit.ly/China_report). The report is forward-looking, with recommendations on how China's capital markets could develop. Of particular interest to treasurers are the sections on FX, laws and regulations, market infrastructure and market access.

While on the topic of China, the Stock Exchange of Hong Kong (incorporating the Hong Kong Futures Exchange) has announced the trading of a new renminbi currency option – the USD/CNH options contract. Further details on contract size and other contract features can be found on the HKEX website.

Virtual bank accounts

Virtual bank accounts were a topical issue at the ACT Europe Conference in Düsseldorf. The evolving regulatory environment will bring increased costs for those banks running notional pooling arrangements. Basel III's liquidity coverage ratio, net stable funding ratio and leverage ratio are some of the culprits. Virtual account arrangements are effectively a halfway house for corporates, representing a hybrid of both cash concentration and notional pooling.

With one 'real' account, but multiple virtual accounts, each with their own unique IBAN (and payment authorisers), funds are still co-mingled. Virtual accounts will not result in getting rid of all but one bank account, but rather a reduction in the number of bank accounts. There will still be a need for a physical account per currency. As legal issues are still being ironed out, we won't see the basic functionality of virtual accounts in action across the UK until the end of 2017.

60-SECOND INTERVIEW

JAMES CROWDER

TREASURY OPERATIONS ANALYST, COMPASS GROUP PLC

How did you get into treasury?
By accident. I was working in bank reconciliation with npower on a temporary basis. They needed someone to do daily forecasting for a period and I stepped in. It snowballed a bit from there.

What do you like about treasury?
The constantly changing environment. You can have a dozen items to do and all of them be different from one another. Also, there is rarely a black or white answer to a question. You have to find the solution within the grey area.

What's the best thing about being a treasurer?
The opportunity to get involved in so many different projects. Within treasury, you have interactions with people from every level and from such a wide range of departments. If there is a project going on, invariably treasury will be involved somewhere!

What's the best thing about being a member of the ACT?
It provides a great source of information and there are so many people ready and willing to offer up advice, no matter what the subject or simplicity of the question.

Which ACT qualifications do you hold?
AMCT.

How has your qualification benefited you in your career so far?
Massively! As someone without a degree or accounting qualification, it has been invaluable.

What's the most important lesson that you've learned during your career?
Whenever possible, take your time over decisions. Jumping in invariably puts you or others in a sticky spot, so be efficient, but diligent, and if you don't know something, always say so or ask. Treasury does not lend itself well to those who try to guess or muddle through.

What would be your best piece of advice to someone else considering a career in treasury?
Be comfortable with admin! There is a lot of fun stuff in treasury we all want to do, but you've got to be happy with mucking in on the little things, too. An 'I'm too important to do that' attitude won't work.

If you would like to star in our 60-second interview slot, email editor@treasurers.org Please provide a photo of yourself, your email address and telephone number. We won't publish your details – it's just so we can contact you in the event of queries.

ACT DIARY DATES

TRAINING, EVENTS & WEBINARS

2017 TRAINING COURSE DATES

22-26 May, London
A-Z of corporate treasury
An intensive five-day overview of the fundamentals of treasury management. This is a perfect forum for new entrants to the profession, bankers and those working alongside the treasury. Throughout the course, you will hear from the best trainers in their field and have access to corporate practitioners. Learn about corporate treasury within the context of international markets, and build a deep insight into the core areas and how they function as a whole through a mix of theory and practical application.

8 June, London
Corporate tax for treasurers
Join us for an overview of the core international tax concepts to consider when structuring cross-border activities, such as intercompany funding transactions.

13 June or 12 September, London
Treasury in a day
A one-day introduction aimed at anyone new to treasury, looking to broaden their understanding of the function or who wants to improve their ability to have better conversations with management, operations, banks or with treasurers as customers. You will learn about the role of a treasurer within the context of business, and you will be introduced to key treasury concepts and financial instruments commonly used.

13 September London
Foreign exchange
Learn about the different types of FX risk and develop an ability to advise both commercial operations and senior management about FX risks and on the responses available to meet those risks from a treasurer who has real experience in this area. You will also discover some of the instruments used to manage FX risks, how they are traded and some of the risks around this, together with the controls that should be used to deal with those risks.

14 September London
Interest rate risk
Gain a deeper understanding of the many aspects of interest rate risk, how it affects different firms and its inevitability. This PC-based course will teach you the concepts for evaluating the different aspects of interest rate risk with hands-on modelling experience.

To view more courses or to book online, visit academy.treasurers.org/training
For more information contact Radmila Trkulja at rtrkulja@treasurers.org or tel +44 (0)20 7847 2573

ACT EVENTS 2017

16-17 May, Manchester
ACT Annual Conference
The most powerful treasury and finance debate returns to Manchester. Our new two-day format delivers unrivalled content and networking opportunities, only in a smarter, more compact set-up that means less time out of the office.
www.treasurers.org/annualconference

23 May, Dubai
Middle East Breakfast Briefing
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{ INTEREST RATES }

JEREMY WARNER

The consequences of ultra-low interest rates are getting harder to live with

Ultra-loose monetary policy has undoubtedly played an important part in saving the world from some of the worst consequences of the financial crisis. But, in nearly all other respects, its effects have been decidedly unwelcome; by destroying the market's normal pricing disciplines, it is almost certainly incubating serious problems for the future.

Here are a couple of examples of these undesirable side effects, both to do with the distortions that the zero interest rate policy has introduced into the insurance market. Trivial though they may seem in the context of the overriding problem with negative real interest rates – that they have obliterated investment returns – they nevertheless neatly illustrate the sort of anomalies we are beginning to see the length and breadth of the commercial landscape.

The first concerns the so-called 'Ogden rate', part of a range of guidelines used in the UK to determine the size of insurance claims in cases of personal injury. A few months ago, the Ministry of Justice announced that it was cutting the discount rate, applied to lump-sum compensation to claimants who have suffered life-changing injuries, to -0.75% from +2.5% to reflect the much lower interest rate environment that now rules. It's one of those decisions which, though logical enough in principle, is round the bend in practice, with some very unfortunate consequences for all but the claimant. For sure, any lump-sum award is bound to earn a lower rate of return over a lifetime than it used to, but, because the assumed rate of return is going to be so much lower, the original lump-sum award must correspondingly be much greater to match the decided level of compensation. Many insurers have had to significantly raise their provisioning accordingly, and nearly all, particularly in motor insurance (where the great bulk of these claims take place), warn of a big rise in premium charges to come. Great result. It's like something out of the Mad Hatter's tea party.

SHUTTERSTOCK

The second example concerns the growth of 'alternative reinsurance capital'. This is very much a phenomenon driven by low interest rates. Poor returns from more traditional investment assets have sparked a worldwide hunt for yield. Investors with little or no experience of insurance – hedge funds, sovereign wealth funds, pension funds and mutual funds – have been piling into the sector in the hope that it offers a better form of low-risk investment than they are getting elsewhere.

Such new sources of capital have been growing like Topsy since the financial crisis, when unconventional monetary policy became the order of the day. Aon Benfield estimates that, from a standing start, alternative capital has come to account for between 40% and 50% of catastrophe reinsurance worldwide.

This has, in turn, blurred the boundaries between traditional insurance broking and underwriting, with brokers increasingly offering clients an end-to-end proposition that both chooses, underwrites and reinsures the risk using these new, external sources of capital. The potential for conflicts of interest, and possibly eventual inability to pay, scarcely needs pointing out.

It is, of course, possible to put a more positive spin on the growth of alternative capital, which has considerably expanded the capacity of the market, arguably making it more competitive and driving down reinsurance rates. Yet its rapid emergence as a force to be reckoned with also raises the question of what happens when interest rates start to rise again, or indeed what happens when we return to a more normal pattern of catastrophe events, let alone a really bad run of them. In any case, both alternative capital and the market as a whole could be in for a rude awakening.

As I say, the low interest rate environment is giving rise to all manner of market anomalies. Many of them are an accident waiting to happen.

Both alternative capital and the market as a whole could be in for a rude awakening

Jeremy Warner is assistant editor of *The Daily Telegraph* and one of Britain's leading business and economics commentators

The mercantilist delusion

Trump's dislike for trade deficits overlooks fundamental tenets of economics

Scaling up basic logic can be hard; especially, it turns out, if you are an unusual president. Would Trump, self-proclaimed dealmaker, be willing to trade three of his golf courses, worth together, say, $300m, in exchange for one building worth only $100m? Would he consider that a great deal? Of course not. Yet when it comes to the US trade balance, that is exactly what he hopes to achieve.

When Trump says that trade deficits are bad, what he is really saying is that he would rather see US workers exchange more of their stuff for less from abroad. When it comes to international trade, this mercantilist delusion, an economic illogic, is spouted all too often.

It is easy to miss the obvious point if you view a country's trade balance as if it were just the difference between revenues and costs in a business. The benefit from trade is not what a country sells, but what it buys. If American workers can permanently consume German cars and Chinese electronics that cost more than American-made goods they send to Germany and China, they are getting a pretty great deal.

That a trade surplus is always favourable is a misconception. A trade deficit of, say, $50bn, for country X to country Y doesn't represent a $50bn loss for country X. Instead, it shows that X can consume $50bn more of goods from country Y than it has to send in return. The major aim of trade, as Adam Smith argued, is to export as little as possible in exchange for importing as much as possible. Nothing has changed in some 250 years since Smith's day.

Rich countries like the US can afford to permanently run modest trade deficits because foreigners are willing to supply the US with surplus cash via investment or credit. The US enjoys the highest foreign direct investment in the world because, thanks to its strong economy, it has a risk-return profile that attracts foreign investors. US households benefit from this through higher consumption by way of trade.

While some industries can lose out to more competitive foreign producers when a country opens up to increase its trade, there is no link between the overall trade balance and employment, or economic growth. Let us compare the US and the UK against Germany and Japan. All are highly developed economies. All enjoy low unemployment. And yet the US and UK, with their persistent trade deficits, tend to enjoy faster economic growth, on average, than Germany and Japan.

SHUTTERSTOCK

Trump threatens trade tariffs for countries that the US runs a trade deficit with. Thanks to the laws of economics, such measures would, in the end, prove futile. America's southern neighbour, Mexico, has become the scapegoat in this debate. But what if the US increased taxes on Mexican imports? For a time, the higher costs of Mexican goods for US consumers would indeed reduce US demand for them. But over time, the damage to the Mexican economy from weaker exports to the US would cause the Mexican peso to depreciate relative to the US dollar, offsetting the effect of the tariff and, ultimately, raising US demand for Mexican goods again.

Tariffs aimed at lowering foreign imports to protect US jobs are politically favourable, since they generate concentrated benefits for the protected workers, while spreading the much higher costs thinly across the whole US economy. History provides a nice example. In the 1970s, successfully lobbying efforts by the US auto industry to limit Japanese auto imports benefited Detroit's autoworkers for a while. But in the end, by blocking foreign competition, the quality of US cars began to lag behind the more efficient Japanese and European cars. The US car industry lost some of its market share as a result. Only by making US households poorer in order to reduce their demand for foreign goods could Trump rebalance US trade.

In a worst-case scenario, other countries would retaliate to US protectionism. Such tit-for-tat protection would hurt the global economy badly.

Luckily, as we learned from Trump's failed attempt to eliminate Obamacare, the US political system can hem in even the most unusual president. This materially limits the opportunity to press forward with US protectionism so that the winds of global trade can continue to blow harder than Mr Trump's windy rhetoric.

Rich countries like the US can afford to permanently run modest trade deficits

Kallum Pickering is senior UK economist at Berenberg Bank

{ EVOLUTION }

PETER GOSHAWK

The ACT's president charts treasury's course from Cinderella status to strategic presence

I first encountered treasury as a subject during my accountancy training. It was fascinating and much more fun than the rest of the training scheme. As a consequence, I asked to join the director of funds department, British Rail's treasury function, in 1981 as a newly qualified accountant. That fascination with treasury has stayed with me throughout my career from corporates to banking, and then on to non-executive work, including as a pension fund trustee.

The ACT became part of my professional life in 1985, when in the Hawker Siddeley Group. *The Treasurer* encouraged membership of the ACT and the regular meetings of the London West End regional group offered a good training opportunity from sage treasurers of the day.

Treasury was a somewhat esoteric label, and this has consistently been a blessing and a curse for my career, and I suspect for other career treasurers. The blessing is we treasurers supposedly know things others don't. The curse is we are too easily labelled as specialists and need to prove our capability for more general management as our careers progress. However, there is a similar dialogue on transferable skills when progressing from an executive career to a non-executive career, so maybe it is just another hurdle to jump.

SHUTTERSTOCK

The other evolution occurred as treasury moved from its specialist, and sometimes Cinderella, status to become a rather essential piece of good governance. This was very much the case for financial institutions during the banking crisis. Treasurers moved from picking the money off money trees to the centre of focus, with board members receiving daily briefings on capital and liquidity.

The value of deposits, and particularly customer deposits, moved from a rather unprofitable and somewhat tedious activity to fuel the more glamorous activity of lending, to becoming the pinch point for any lending activity at all. Capital management in banking is now a primary point of reference for any investor presentation. I can still remember investors challenging banks at debt-investor roadshows: 'Why can't you be more like Northern Rock? They are the most efficient bank in Europe.' How times change.

I recall how in a large banking group the divisional or subsidiary asset and liability committees were quite difficult to populate. Commercial business heads would often delegate this to back- or middle-office personnel. It was sometimes considered a distraction.

Post crisis, the role of treasury and the activity of risk governance has undergone a dramatic change in priority and consumption of the board agenda. Even in 2010, in a building society, I was party to the debate on whether we needed a risk committee. Audit committees did not need similar justification; they were already established as a key element of good governance. Today, the board risk committee agenda is so full with work on regulatory returns and enterprise-wide risk management that the frequency and duration of these meetings far outweigh the comparable audit committee agendas.

During this time of evolution and revolution, the ACT has been there as a centre of excellence and tool chest for treasury departments. It has provided consistent input towards a rapidly developing specialist skill set. It has supported the need to explain and deliver those skills at a strategic level across the whole organisation. It has had a significant part to play in making treasury an essential part of business planning and delivery. For all those reasons, I am delighted to be a member of the ACT, ever more so in my capacity on council and as I now take up the term of president.

The ACT is built on the expertise of its members and that has always been on a basis of mutuality. Many members give significant time and effort to the ACT. This is a great support to the overall membership. It is also equally rewarding to those who take part in all sorts of opportunities to enhance skills and networks that will serve you well in your career. I have thoroughly enjoyed the ability to learn from others and the feeling of achievement from being an active member of the ACT. I hope that if you haven't already done so, you will try it and enjoy the experience.

Treasurers moved from picking the money off money trees to the centre of focus

Peter Goshawk is ACT president and chair of Barclays Pension Fund

VITAL STATISTICS

3,400
the number of Webcor Group employees around the world

2,100+
the number of local employees in Africa

110
the number of points of sale in Africa

300+
the number of products imported and exclusively distributed in Angola

35
the number of years Webcor Group has been operating in Africa

"We're a very decentralised group, so a lot of my role is to centralise much of the treasury function"

SEEING IS BELIEVING

Centralising treasury and increasing cash visibility at food and FMCG group Webcor have been priorities for head of treasury Mona Lockett

Words: **Rebecca Brace** / Photos: **Mark Brown**

No challenge is too great for Mona Lockett, head of treasury at food distributor Webcor Group – from pioneering the use of treasury management systems (TMSs) in Angola to managing stock levels during an economic crisis.

Established in 1978 in Zaire – modern-day Democratic Republic of the Congo – Webcor Group began as a food company. By 1992, the company had become a leader in soft commodities and fast-moving consumer goods (FMCG) in Angola. Today, the company has a global presence in Europe, the Middle East, Latin America and Southeast Asia, as well as its core operations in Africa.

Ninety-five per cent of the company's revenues are generated in Angola, where the company imports commodities and FMCG, and sells them through its own distribution company. In total, Webcor Group distributes more than 300 consumer products across Angola, Mozambique and the Democratic Republic of the Congo using door-to-door and route-to-market methods.

Lockett is based in the company's recently established corporate headquarters in Dubai. "We're a very decentralised group, so a lot of my role is to centralise much of the treasury function," says Lockett. "This includes trying to manage the group debt and group cash from a central perspective in order to bring visibility to the group. I also work on the trade finance arm, and I get involved in project finance, because we have a lot of industrial projects in Angola."

Lockett's career path has incorporated a number of roles in treasury, although her focus was initially on accounting. After studying accounting and finance at university, she moved into a private practice. A period of travel followed, after which Lockett returned to the UK and took on a contract treasury role at EDF Energy, as the company prepared for the London 2012 Olympics bid. "It was interesting – I thoroughly enjoyed it," she says. "They needed somebody with a bit of accounting experience, which always seems to help when you're going into treasury."

Lockett established a limited company, MPL Treasury Consultancy, in the UK in order to cherry-pick the treasury projects she wanted to work on as a consultant, which enabled her to gain considerable experience, before joining Webcor Group in 2014. Lockett attributes her rapid progression to her ACCA accounting qualification, as well as her AMCT. "These qualifications bring the foundation that will help you throughout your career," she comments. "It's all very well having the experience, but having the piece of paper adds weight and shows not only commitment, but trains you in the principles."

A member of the ACT, Lockett also notes the value of the networking opportunities and the ability to consult with industry peers. "A lot of times, we find in this region that everyone is in a

TOP TIPS FOR OTHER TREASURERS

1. **Be prepared to get out there. A treasurer's role involves a lot of communication at all levels – networking is an important part of the job. The treasury world is small, so building and maintaining relationships is key.**
2. **The AMCT qualification gave me the solid foundations on which I have built my career today. It's true that what you do in practice varies from what you learn at school. However, learning and understanding the principles of treasury through the programme has added immense value to what I do today.**
3. **Where gadgets are concerned, I am quite old school. While most people are attached to Apple's latest invention, I am still going strong with the 'almost-out-of-date version'.**
4. **Every day brings a challenge. No question is too tough – my role is to find the solution.**
5. **The best way to wind down after a stressful day is a good workout. However, living in Dubai has its benefits, and beaches are plentiful.**

similar situation," she explains. "When things go wrong, they tend to go wrong for everyone – so reaching out to your network to help find a solution has been very useful."

OVERCOMING THE OBSTACLES

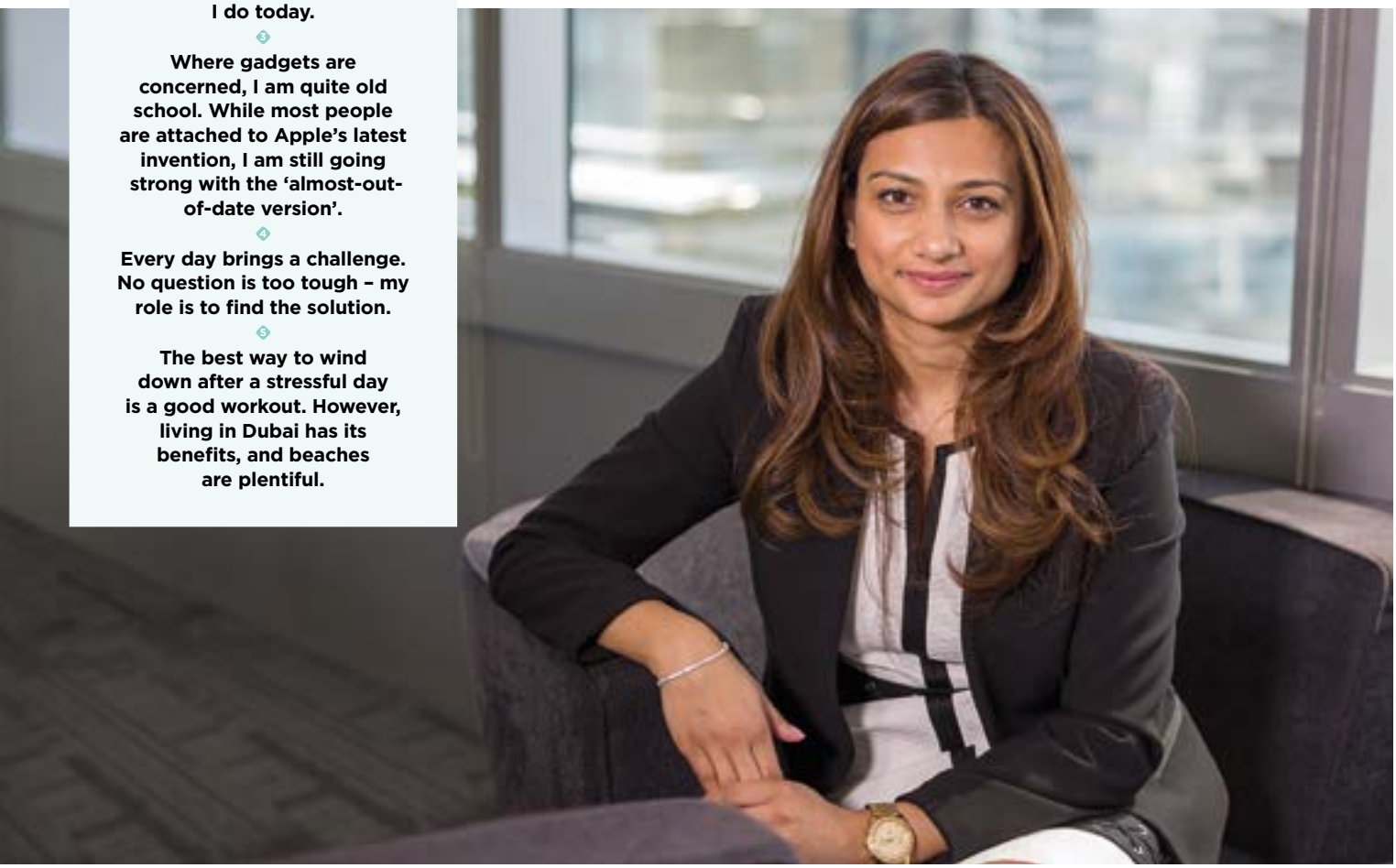
Indeed, the company's geographical footprint has led to considerable challenges where treasury is concerned. When working with local banks, for example, Lockett says that it can take time to find the right person to speak to. She adds that treasurers may also find themselves having to educate their banks about what they need.

Even straightforward processes may take considerable time and perseverance. Lockett has experienced delays on opening bank accounts, for instance. "So there are parts of the role that can be frustrating and compliance now also plays a big part in these delays."

Undaunted by these challenges, Lockett has made considerable progress in the past couple of years in streamlining treasury processes and using technology to drive improvements. When Lockett joined Webcor Group, the organisation had no treasury system in place. As such, the treasury was dependent on spreadsheets provided by finance managers based in Angola, Beirut, Dubai and Geneva. "We were looking back two months, rather than looking ahead," observes Lockett.

All this is changing. Lockett has recently started implementing a new TMS in order to achieve greater visibility over the organisation's cash. With phase one complete, Lockett says the new system has begun to bring things to life. She adds, "It has also helped identify talent within the group and

> "These qualifications bring the foundation that will help you throughout your career"



a few hidden treasures!" For example, the senior management and treasury is able to receive data on a daily basis, with visibility over the group's position both by company and by bank.

"We never thought we would have visibility from Angolan banks – but we now have more than 100 Angolan bank accounts spread across over 20 banks reporting onto the platform," says Lockett. "In fact, Deloitte informed us that we are in the less than 2% of companies in Angola that currently have a TMS working."

While the TMS has provided considerable benefits, managing cash and risk continues to be a sizeable challenge – particularly given the crucial role that Webcor Group plays in Angola as an importer of staple commodities, such as flour, rice and maize flour. "All our cash is in Angola, and all our debt is outside of Angola," says Lockett. "If we don't have financing from the bank, we won't be supplying food into Angola – and we are the market leader."

Over the past two years, with the country's economy in crisis as a result of falling oil prices, the company's dynamics have shifted drastically. As a result, treasury has been involved in matters such as managing the stock levels in line with transfer of currency in a controlled exchange market.

"Day to day we had zero visibility on how much cash we could transfer out of Angola to the sourcing companies in order to settle our bank financing," says Lockett. "The economy went through stages of offering purchase at auction, then came the priority on food, medicine and raw material. More recently, the focus is on food imported into the country. This was the biggest challenge across the whole group – not just for me, but also for everyone else, like the general managers based in remote provinces, who needed to know when the trucks would come to fill their warehouses. But we've come together as a team and we've seen this through."

LOOKING FORWARD

Despite facing significant challenges over the past couple of years, such as the devaluation of the Angolan kwanza, the company has recently completed a major strategic project in the country with the launch of a state-of-the-art flour mill. Where treasury projects are concerned, meanwhile, Webcor Group has recently obtained its own SWIFT code.

"My biggest challenge this year is getting the whole treasury centralised," comments Lockett. "We have one centralised hub in Angola that will take care of all central payments through SWIFT in Angola. We'll also continue getting SWIFT up and running, which means going back to the banks to renegotiate fees and explain that we have our own SWIFT gateway."

Lockett is also in the process of implementing a cash-pooling structure, in order to push cash up to the parent company and fund back down when needed. "During the crisis, we often found that there would be one company that had a bit of cash, but the other one was struggling, and we'd have to find a solution to pump the cash," she explains. "Rather than having to touch the shareholders, we intend to build a pocket at the holding level and fund back down. This would be the 'norm' in an established treasury – but driving governance is challenging when local businesses are used to holding on to their cash."

With so much accomplished over the past couple of years, Lockett is philosophical about the challenges that treasury brings – and the rewards that can be gained by overcoming them. "In the past, the part of the job that I least enjoyed was not having control over visibility," she concludes. "Now that we do have visibility, it's one of the parts of the job that I enjoy the most."

MONA'S CV

2014-present
Head of treasury, Webcor Group
2013-2014
Group treasurer,
MPL Treasury Consulting
2010-2012
Group treasury EMEA shared services, Kohler Co
2010
Treasury project manager,
Enzen Global Solutions
2010
Head of cash management, EMAL
2009-2010
Treasury manager, Grosvenor
2006-2009
Treasury manager, Kuoni
2005-2006
Senior treasury analyst, GDF Suez
2003-2005
Treasury accountant, EDF Energy
1999-2003
Financial accountant, Silver Levene

QUALIFICATIONS

BA in Accounting and Finance,
ACCA, AMCT

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Rebecca Brace is a freelance journalist specialising in corporate treasury and banking

FOR THE LOVE OF IT

WHEN WE ASKED SIX TREASURERS WHICH SOFTWARE AND SYSTEMS THEY FIND MOST EFFECTIVE, AND HOW SUCH TECHNOLOGIES COULD POTENTIALLY ADD MORE VALUE, SOME COMMON THEMES EMERGED. LESLEY MEALL SHARES THEIR INSIGHTS

How you start your working day can set the tone for the next eight hours. So it is with treasury IT infrastructure. "I can't emphasise enough how important it is for our access to market data to be completely automated," says Royston Da Costa, assistant group treasurer with Wolseley Group Services, a global distributor of heating and plumbing products.

"It may not be the most important thing, but it adds a lot of value," he explains. Each day, a file from Reuters is automatically pushed into a BELLIN treasury management system (TMS) at Wolseley. "There is no manual intervention. It's arms-length from an audit perspective and it works," says Da Costa. It also goes into the enterprise resource planning (ERP) system. "Market data is the first thing that happens for us each day before the bank statements are imported," he adds, noting the potential to further automate the latter.

"The importing of bank statements is an area we want to try to improve," says Da Costa. "We looked at SWIFT, but decided not to implement it at the time. We use our cash-pool bank to collate all the SWIFT MT 940s from around our group, so we get that visibility nevertheless, but we don't currently make our payments using SWIFT. We still have to manually key them into our banking portal," says Da Costa, who is looking at the controls in Wolseley's TMS before assessing payment options, including SWIFT, host to host and a hybrid.

PAIN POINTS

Bank statement import has long been a pain point for many treasurers, though technology-enabled solutions have long been available. A decade ago, when Sunil Boorman, assistant treasurer at learning company Pearson, began his treasury career, the corporate he worked for used a multi-bank system that remains one of his favourites because, as he recalls: "When you got into the office each morning, you knew that your statements and your reconciliation were basically done, and you just needed to analyse the data."

Each day, the 40 or so banks the corporate used globally would send their MT 940 statements to a single bank, JPMorgan. It would reprocess the information to create a single file and format, then transfer this into the corporate's TMS (a high-end offering from Wall Street Systems). Likewise, the corporate would send an MT 100-type message for all outgoing payments to JPMorgan, for reprocessing into the different formats required by various other banks.

There's a massive automation and straight-through processing (STP) point there, says Boorman: "The connectivity and visibility of that set-up was invaluable." Now, in his role at Pearson, he is working on an implementation with similar functionality, based on a SWIFT service bureau. "They can transform the data into whatever format you need. They will even take the pain out of doing a lot of the documentation you need for SWIFT.

"Once the data is fed from the SWIFT service bureau into the TMS, reporting tends to be much quicker and easier, since the information is already consolidated. There is no need to manually download data from multiple banking portals and create Excel reports, so it avoids potential Excel errors," says Boorman.

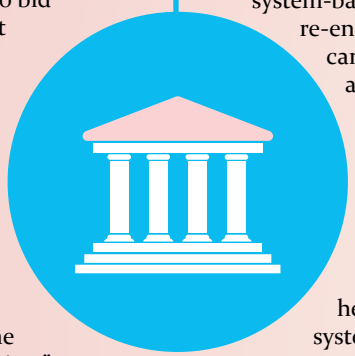
FX FAVOURITES

Ask Rando Bruns which system has been most useful during his career and the head of group treasury for the global pharmaceutical giant Merck chooses an electronic trading platform for FX, 360T. "It allows us to automate a high proportion of FX trading processes, including replication in the TMS and

"Market data is the first thing that happens for us each day before the bank statements are imported"

accounting system, while at the same time improving transparency and pricing," says Bruns, who is not the only treasurer to appreciate electronic trading.

"Online dealing was a big game changer for us," says Da Costa. It meant that Wolseley Group's treasury could automate its dealing process, providing more than two banking partners with an opportunity to bid on their trades at the same time. "I think it's important to speak to your banks and build and maintain relationships with people," he says. "You'll always need some human intervention." Though technology and its capacity to engineer unnecessary human interaction out of treasury processes can be a large part of its appeal.



PROCESS RE-ENGINEERING

Christof Nelischer, global group treasurer with advisory, broking and solutions company Willis Towers Watson, says: "I view technology as an enabler that helps us to get the most out of people, by working effectively rather than long hours, and avoiding menial tasks you don't need a human brain for that a system is perfectly capable of." Nelischer is a fan of the system-based process re-engineering that can enable this automated approach to creating an efficient treasury technology infrastructure.

> "I think it's important to speak to your banks and build and maintain relationships with people"

One example he shares, where system-based process re-engineering demonstrated its worth, was the introduction of European Market Infrastructure Regulation (EMIR) regulatory reporting on derivatives in 2014. The global group treasury dealt with this by working with a number of its software providers to 'engineer' an automated solution.

Nelischer worked with Misys to come up with a report out of that system and into a confirmed repository, and with a TMS provider and a dealing platform to feed correctly into Misys, so that data moves to and fro automatically. The result, he says, is a 100% matching rate: "Correctly configured, with no faults in the process, there is no exceptional situation that needs manual intervention, and it all works automatically. There's no error. We haven't had a mismatch on confirmations since 2014."

This said, these processes are not totally automated. There is still a role for a human being: a treasury colleague does static data management and monitors automatic transactions on a screen in Mumbai, where Willis Towers Watson has offshored some work. "I consider this an example of technology adding real value," says Nelischer. "This is work that has to be done, but in itself, it doesn't add any real value. Now, it's almost entirely automated and one person spends just half an hour a week monitoring it."

REGULATORY DRIVERS

Nelischer isn't the only treasurer driven to greater automation by EMIR. It was also behind the Wolseley move to replace spreadsheets with a TMS. "Regulation does not discriminate between big and small," says Da Costa. You have to report all eligible (internal and external) derivative trades under EMIR and Wolseley also had to demonstrate hedge effectiveness under IAS 39, *Financial Instruments: Recognition and Measurement*. "Our auditors wanted to see systems in place to document and produce the level of compliance required," he says.

Wolseley worked with its TMS provider BELLIN to get this. This contrasts with the experience of Robert Scriven, group treasurer and planning manager with the Edinburgh-based oil and gas company Cairn Energy, who also looked to software for help with EMIR compliance. "The TMSs I knew about were not set up for EMIR. They did not seem to look at the industry direction and build ahead, ready for change. They seem to react to what big customers want and the rest of us get the cast-offs from that," he says.

THE WISH LIST

We asked treasurers what they most wanted their IT infrastructure to help them achieve and what they would like to see in an ideal world.

1 "STP across all treasury technology to avoid the need for rekeying and manual uploads and downloads."

2 "Full integration, so we can deal from the TMS, and STP to confirm, EMIR report and settle."

3 "Subsidiary budgets and forecasts to be automatically loaded into the TMS from the ERP in order to get greater visibility over group FX exposures and cash-flow forecasts."

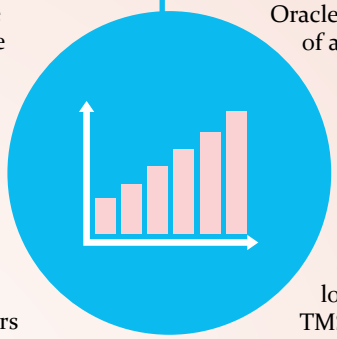
4 "Central visibility and control of all bank accounts."

5 "A reduction of bank accounts – each bank account not only has hard financial cost, but soft costs around the company, such as reconciliation and maintenance of the data across multiple business processes."

6 "Central control of all cash."

7 "Better coverage in one dealing system of product classes, deposits, FX, repo and MMFs."

Nonetheless, a TMS can deliver unexpected benefits. Wolseley's first TMS implementation in 2006 was driven by IAS 39 compliance. "In 2010, we put in a cash-pooling structure with BMG and we needed to have a solution in place that demonstrated that we were using the cash more efficiently," says Da Costa. Wolseley considers itself a follower, not a technology pioneer, but its driving mantra is now automation and STP.



INTEGRATION MATTERS

Degrees of integration vary across the components in the technology infrastructures these treasury professionals are developing, but they are all working to integrate progressively more systems – and for good reason. "Treasury systems need to be interconnected within the treasury system landscape, as well as with the ERP systems, in order to have highly automated treasury processes," says Bruns, who dreams of a perfect world where one group-wide ERP integrates with the treasury systems.

Just integrating an ERP and treasury and risk management system isn't end-to-end STP, but it can still deliver big benefits. Raj Nandkumar, treasurer at the Private Export Funding Corporation (PEFCO), a provider of US dollar loans to foreign importers, says: "The integration has improved our operational efficiency in terms of time and control. What used to take two or three days at month end for hedge accounting now takes half an hour in Reval, with general ledger entries posted to Oracle at the touch of a button."

At Cairn Energy, Scriven may have struggled to tackle EMIR with a TMS, but he still chooses a low-cost TMS as the technology that delivered the "biggest gains" of his career, with its "single central source of data and no rekeying". He also notes how important integration is to treasury automation efforts. "It is essential that you make the effort to link up to other systems," says Scriven, who would like the suppliers of various treasury-related software and services to make this easier to achieve.

"Lack of built-in integration of TMS, dealing software and data tools such as Bloomberg are big failings," says Scriven. "They all need to be joined up more, using a single standard communications protocol – and out of the box, not rebuilt for every client, in a custom, time-consuming and costly way." It can be easier to integrate cloud systems (with the application planning interfaces (APIs) they provide for connectivity) than it is to integrate traditional systems, but even cloud implementations need some IT expertise.

MORE SOFTWARE SUPPORT

"Before we opted for a cloud implementation in September 2015, I thought we wouldn't need help from IT, but we do," says Da Costa. "Because of our reliance on automation, we need secure file transfers (SFTs) in place for a number of processes, and our general approach at Wolseley is that we like to control those processes. We want to be able to pull and push the data to external vendors," he explains, so IT support is still required, though, as Da Costa adds: "It is minimal."

Better integration between systems and services could transform treasury, whether it's achieved through standardised communications protocols, more APIs and other connectors, or convergence between products such as 360T and Misys. "They link with the same external counterparties and load to and from TMS, and there are natural synergies with ERP, such as Oracle," says Nelischer.

Then, as treasury processing becomes more virtual, treasurers could add more value by focusing on their business advisory role. "Treasury processing eats up so much time and energy, and doesn't add any value. It needs to happen, but how is immaterial," says Nelischer. "Systems become more effective when they talk to each other, and the measure for effectiveness is your STP hit rate, so the more integrated systems the better." Perhaps that should set the tone for the next eight hours and the next eight years.

THE WISH LIST

We also asked which problems treasurers would most like to see resolved.

1 "Banks with common interfaces and template requirements, especially across their own branches globally."

2 "TMS providers being more willing to create and provide standard interfaces for corporates to reduce implementation effort – often interfaces are required to be built from scratch."

3 "Risk management analytics – TMSs providing a more efficient process of running simulations to test hedge effectiveness."

"Lack of built-in integration of TMS, dealing software and data tools such as Bloomberg are big failings"

Lesley Meall is a freelance business and technology journalist

THE EDUCATION BUSINESS

POORLY DELIVERED TRAINING PROGRAMMES ARE MORE THAN CAPABLE OF ERODING BENEFITS FROM NEW SYSTEMS OR FAILING TO EQUIP PEOPLE TO DEAL WITH PROCEDURAL CHANGE. ANDREW BURGESS EXPLAINS HOW TO TEACH

Things change in treasury all the time. New systems, new regulations, new procedures and new policies get introduced and rolled out across various parts of the firm. This means a lot of people both inside and outside treasury may need to get up to speed on how to understand, apply and function with whatever the latest change is.

That's not going to get covered with a presentation, no matter how good the PowerPoint. People don't just need to *know* about something; they need to know how to *do* something. Of course, if it's just a matter of raising awareness, you can probably confine yourself to forwarding an email. However, as long as treasury is responsible for implementing changes, you are in a teaching situation. And sometimes budget limitations, the time frame or sensitivity in terms of the material, means that bringing in external specialists is not an option. It's down to you to set up a training programme.

Luckily, we are all experts at teaching, having spent years in school observing at first hand, right? And it's pretty simple: those who can do and those who can't teach, right? Usually, when people disparage something, it's a way of dealing with their collective fear. Because there's another saying: if you don't think teaching is a skill, you should try it sometime.

Seriously, how often have you seen an expensive change-management process flounder because the end users were unsure how to operate with it once in place? Isn't that often a failure of investment in the instruction and teaching element of the change rather than in the actual process or system itself?

None of this helps with getting your training programme set up, however.

The good news is, if you can remember the last really bad class you had to sit through, you are halfway to beating that low bar. The question is, how confidently you want to clear it.

1. BEFORE YOU BEGIN

The lead instructor needs a fairly thorough understanding of the existing situation and what the change will result in. Also useful would be an understanding of why the change is taking place, and how it's to be implemented. That way, they can map out the whole learning process needed.

They will also need to be familiar with the resources available for teaching. There are three main ones: the first resource is time, both in terms of how long before the lessons need to be embedded in the learners' heads, and how long they will be available for those lessons. The second is the instructors themselves – how many and how qualified in both the subject matter and training skills? (There might be resources available via HR, and your organisation may also run to internal education experts, who are able to advise and support the set-up of the programme – and certainly worth a quick call.) The third resource is physical: rooms, computer access and so forth. Organising these elements is also a time consideration in itself.

2. WHAT TO TEACH

What population of the firm are you aiming at? What do they need to be able to do? What can they do at the moment? These and other related questions need to be addressed.

There is a balance to be struck between how much is actually needed to enable people to function (including reaching the point where they can troubleshoot for themselves) and the added skills that you might want to class as 'nice to haves'. There is a phrase used in teaching – lies told to children – for the deliberate simplification of details to keep the complexity reasonable for the group's understanding level.

IKON IMAGES

Does the class actually need to explain the *why* behind the lesson content, or just be able to apply the *what* and *how*?

Another way of looking at this is to ask: does the class actually need to explain the *why* behind the lesson content, or just be able to apply the *what* and *how*?

Assessing those questions will give an indication of what load you, as a teacher, need to take on.

A good way to do this is the old sculptor's trick – take a large block of stone and cut away everything that does not look like an elephant – edit down from a full to needed level of knowledge.

3. HOW TO STRUCTURE TEACHING SESSIONS

Now you know the actual objective to reach, it's just a matter of implementing it. Look at the skill(s) to be taught, whether it is: recognising a potentially suspicious transaction to highlight for investigation; booking derivative transactions; or generating an investment strategy. Break the process down into the finer pieces of skills and work to teach these.

Build the class level up in each separate skill gradually. For complex processes, begin with the straight-through, everything-works-first-time version. Do not be lazy and try to teach the whole process once by mentioning every possible permutation along the way: "if this happens... if that happens... if the other happens...", because that structure can barely be followed by an expert.

Instead, build up slowly, getting gradually more complex in stages. That approach means you can lead a group to do things that they'd consider impossible at the start. Get the learners used to how it should work. Then show them how to deal with the most likely, or most serious, problems if those exceptions occur. Think of it this way: do you really need the whole class ready to deal with 'I've never seen these happen, but both are theoretically possible' events, or just know who and when to call for help?

4. HOW TO TEACH

Listening is more important than talking as a teacher. The answers you get to questions let you know whether it's time to move on, step up the pace or step back and go over something fundamental more fully. Listen not just to what is said, but how. Is the learner confident? Are the questions coming just from the one individual who has 'got it', while the rest of the class tries to avoid being asked anything? Is apparently confident questioning based on a misconception? (Forward points are always positive!) The questions that appear to interrupt the class are valuable for assessing this.

Did you know questions can be open or closed? How is an open question different from a closed one? Open questions require an extended answer to how/what/why questions and probe understanding (like the second question), while closed questions only need a short, often yes/no, answer to quickly confirm facts the learners know (like the first question).

Empathy helps. Sometimes an expert is the worst teacher; they just >

don't understand that people don't understand. So the computer specialist who programmed the application for the past two months and nothing else can't always relate to why the booking clerk who uses it once a week isn't familiar with all the sub-screen options.

Patience shouldn't even need to be stated. Your objective is to get a certain level of ability to act into the learners to enable them to carry out actions as needed, not to finish in 15 minutes. The learners' needs are the important ones; you must go at their pace.

However, while simple is good, the lesson should progress at a pace that allows people to stay engaged and interested. Be flexible and jump ahead to more active exercise areas if people are zoning out. If that means the class splits up into subsections, so be it. Having a teaching assistant available to step in is a luxury to grab, if you can get it.

Imagination is also useful; rephrasing a key concept as an image enables it to stick in the brain better. I explain to project controllers that treasury hedging is like a submarine, very powerful at dealing with any threat in the water, provided we get the information it's there via the 'narrow periscope' of exposure data that the controllers show us. Or that an excess exposure in the enterprise resource planning system is a zombie – it will never die unless actively closed out.

Repetition is the mother of clarity. But it's undeniably boring to keep repeating your message to reinforce it. Save repetition for the important key takeaways. And vary the format of the repetition to keep it fresh to the audience.

5. AFTER INSTRUCTION

Once the active teaching phase is over, it's the students' learning time. The most effective teachers step into the background and support this out of the limelight. Providing good support documentation after the class for referring back makes learning by application and practice more effective.

Encouraging revision both in the immediate follow-up period and after a pause of days, weeks and (ideally) months improves retention rates. Being available for questions is helpful, but don't become a crutch. The principle of answering questions with questions that lead the student back to find the answer for themselves has a long history in teaching – it's called the Socratic method. It takes a little more time and effort in the short term, but the payoff is the pupil becomes less likely to ask for support, because they don't need as much.

Testing your learners is a good way to reinforce key learning points and build confidence when done right. It's also a good way to test the training package effectiveness and adapt to make it better, especially if repetition is likely with other or similar classes.

As we said, teaching is a skill, too, and that means you can get better at it. It would be a shame to waste the learning opportunity...

DO

- Invest time in lesson planning, leaving enough time to adapt the programme as needed.
- Test for understanding.
- Animate and engage the whole class.
- Phrase the same point in different ways; one good insight is worth gold.

DO NOT

- Get sidetracked so that the material becomes irrelevant to a large portion of the class.
- Provide handouts with *new* information in advance.
- Get cheap on training time and have overlarge classes.
- Try to mix classroom and teleteaching groups.
- Delude yourself that one full-speed demonstration is teaching.

IKON IMAGES

Andrew Burgess is FX manager at GE Alstom

CASH INVESTMENT AS REGULATIONS CHANGE

THE MONEY MARKET FUND INDUSTRY IS SET TO CHANGE DUE TO THE INTRODUCTION OF A NEW REGULATION. ROBERT O'RIORDAN REPORTS ON THE EFFECT THIS WILL HAVE ON CASH INVESTORS

SHUTTERSTOCK

A new regulation is set to transform the European money market fund (MMF) industry. It is now close to being published in the *Official Journal of the European Union*, which will make it binding under European law. There will be an 18-month implementation period, but due to the structural changes outlined in the regulation, the impact on the MMF industry will be felt some time before this period ends. This changing landscape is leading investors and asset managers to consider new approaches to how they manage cash.

LESSONS FROM THE US

In the US, a new MMF regulation introduced in October last year has had a substantial impact on the MMF industry there. Under the new regulation, prime funds, which invest predominantly in unsecured short-dated credit, have converted from constant net asset value (NAV) to a variable NAV with gates and fees.

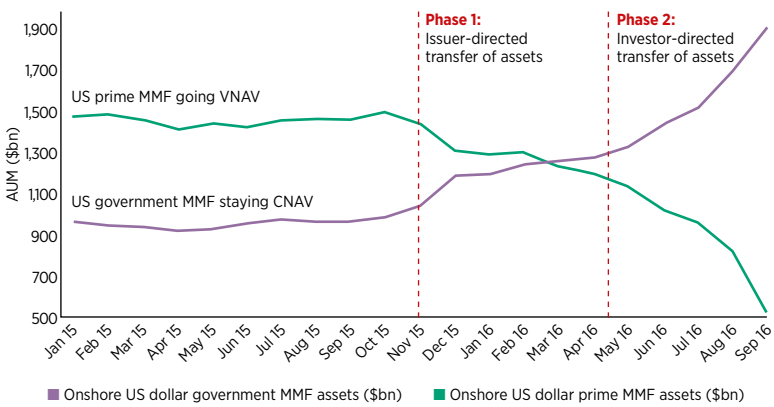
Government funds, which invest in government debt or repos secured against government debt, have maintained their constant NAV status. As a result of these changes, more than $1 trillion of assets moved from prime funds to government funds. (See Figure 1.)

A SIMILAR IMPACT IN EUROPE?

In Europe, a key concern for many investors is whether there will be a similar impact on European MMFs once the regulations go live. As a result, they are already considering how to maintain all the benefits they enjoy from current cash investments – in other words, whether there are approaches that can maintain a constant NAV along with other characteristics, such as diversification, liquidity and yield.

Under the proposed European regulation, government funds will be able to maintain a constant NAV. However, prime funds will either have a variable NAV status, or be categorised as

FIGURE 1: IMPACT OF US MMF REGULATION



Source: iMoneyNet as at October 2016

'low volatility variable NAV' (known as LVNAV) funds. (See Figure 2 for details.)

Compared with the US regulation, the big difference in the European regulation is the introduction of LVNAV funds as a category. These funds will be able to publish a constant NAV if tight criteria are met. However, in stressed market conditions, such as a credit crisis similar to 2008, some LVNAV funds may not be able to operate within those strict criteria – and would therefore be forced to publish a variable NAV. The probability of this occurring in a difficult market environment is exacerbated by the decision to ban sponsor support of MMFs under the proposed regulation.

Yields could also be affected under current proposals. For LVNAV funds to publish a constant NAV, they will be required to greatly shorten the maturities in their portfolios. The funds will only be able to value securities as constant NAV if they have maturities of up to 75 days, which has been greatly reduced from 397 days. For securities between 75 and 397 days, they will need to use mark-to-market pricing methodology. An LVNAV fund will only be able to publish a constant NAV if the overall portfolio NAV remains close to the constant NAV. These restrictions effectively mean LVNAV funds will need to hold securities that mostly mature within 75 days, and the resulting shortening of portfolio maturities would reduce potential yields. Because the repositioning would need to happen well before the end of the 18-month implementation period, investors are likely to feel the effects much earlier than the final deadline.

FIGURE 2: PROPOSED EUROPEAN REGULATION INTRODUCES NEW CATEGORY

	Pre-regulation	Post-regulation		
	IMMFA MMF	Government CNAV	Prime low volatility	Prime variable
Fund type	CNAV	CNAV	LVNAV	VNAV
Accounting methodology	Amortised cost	Amortised cost	Amortised cost up to 75 days	Mark to market
Maximum weighted average maturity (WAM)	60 days	60 days	60 days	60 days
Maximum weighted average life (WAL)	120 days	120 days	120 days	120 days
Maximum individual security maturity	397 days	397 days	397 days	397 days
Minimum daily liquidity	10%	10%	10%	7.5%
Minimum weekly liquidity	20%	30%	30%	15%
Gates and fees	Gates (UCITS/ prospectus)	Gate & fees (regulation)	Gate & fees (regulation)	Gates (UCITS/ prospectus)
Eligible investments	Money market instruments, govt debt	Govt debt, reverse repo, cash	Money market instruments, govt debt	Money market instruments, govt debt

Source: Insight Investment. For illustrative purposes. IMMFA stands for Institutional Money Market Funds Association

With so much uncertainty ahead for prime funds, many investors are looking at traditional constant NAV government funds as defined under the draft regulation. But they offer materially lower yields relative to prime funds, which has historically deterred investors.

IS THERE A BETTER WAY?

Traditional government funds are typically reverse-repo funds with banks as counterparties. Funds lend cash to the banks in return for gilts or government bonds as security, similar to a secured loan. The banks source the gilts or government bonds from other non-bank counterparties where they do a similar secured loan, but this time they are the borrowers of the securities.

In other words, banks are the middlemen profiting from the difference between the amount of interest they receive from the non-bank counterparties and the amount they pay out to the government funds. But this spread has widened greatly in recent years, as a result of the capital requirements outlined under the Basel III banking regulation, meaning that cash investors receive a lower yield for their investments and it is more expensive for non-bank counterparties to access cash.

Some cash investors are now opting for a government constant NAV MMF that cuts out the banks as middlemen and interacts directly with non-bank counterparties, allowing them to avoid the large banking spread introduced by Basel III. This approach offers significant yield enhancement relative to traditional government funds and, in practice, a yield comparable to prime funds.

A related point is that cash investors have struggled in recent years to diversify their cash investments away from banks. This has been high on the agenda of many cash investors since the credit crisis, as banks have experienced many aftershocks, heightening concerns that all their cash may be overexposed to bank credit risk. A non-bank government fund allows investors to diversify their cash away from banks as counterparties, reducing their overall exposure to the sector.

A NEW APPROACH

At Insight, we recognise clients are looking for vehicles that could still maintain a constant NAV, while not having to sacrifice yield or liquidity. A non-bank government liquidity fund can fulfil these criteria and also offer the added benefit of increased security, via gilts or government bonds, with the ability to diversify cash investments away from bank risk.

Some cash investors are opting for an MMF that cuts out the banks as middlemen

Robert O'Riordan is institutional business development director at Insight Investment

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PREPARE TO NEGOTIATE

STEPHEN POWELL AND KATHRINE MELONI SHOW HOW TREASURERS CAN USE LMA INVESTMENT-GRADE AGREEMENTS AS A STARTING POINT FOR NEGOTIATING NEW FACILITIES

Last month, the ACT published a fifth edition of its *Borrower's Guide to the Loan Market Association's Investment Grade Agreements*. The *Borrower's Guide* has been comprehensively revised and updated to address changes made to the agreements and other market developments since the last edition in 2013.

The association's collection of recommended forms provide the basis for, or at least have an influence on, virtually all commercial loan documentation, certainly in the English-law market. Its recommended forms of facility agreement for investment-grade borrowers, the investment-grade agreements (IGAs), were the first primary documents produced by the Loan Market Association (LMA) and are probably the most widely used. The IGAs are the plain vanilla of the LMA's various forms of facility agreement. As such, they provide a baseline for the mechanical aspects of loan documentation and a starting point for the commercial aspects that can be applied across most sectors of the loan market.

The ACT has worked with the LMA on the IGAs since the templates were first developed almost two decades ago. The ACT's involvement is aimed at ensuring that, as far as possible, the agreements reflect an appropriate balance between the interests of lenders and borrowers. However, the IGAs, like all LMA templates, are presented only as a starting point for negotiation. They are intended to be adapted and supplemented according to the circumstances of the transaction. It is important for treasurers to understand that they should not feel prevented by the use of LMA terms from negotiating in their own interests where necessary.

SHUTTERSTOCK

The Borrower's Guide

The *Borrower's Guide*, now in its 18th year, is a reference tool for treasurers working with the LMA templates. It explores the key provisions of IGAs from the borrower's perspective and outlines some of the typical discussion points and more common negotiating positions.

It is divided into four parts:

- Part I describes the IGAs, their place in the broader LMA library and how they should be approached. It also outlines the main aspects of an IGA that are typically negotiated.
- Part II introduces a number of recent developments affecting lending terms (discussed further below), some of which have resulted in changes to the IGAs since the last edition of the guide. This section is specifically aimed at equipping treasurers to anticipate lenders' current areas of focus, as well as highlighting some of the issues commonly of concern to borrowers in current financings.
- Part III is clause-by-clause commentary on the provisions of the IGAs. It outlines the meaning and intent of each key clause, and suggests how they might be viewed from the borrower's perspective.
- Part IV contains an overview of the LMA's finance party default and market disruption provisions. These are optional clauses for use in conjunction with the IGAs. They address the potential consequences of a default by, or the insolvency of, a lender or administrative party and (given the prompt for their production) are colloquially known as the 'Lehman provisions'.

What's new?

It is important for treasurers, with support from their advisers, to keep abreast of recent developments affecting lending terms. Forewarned is forearmed, so it is helpful when embarking on a new financing to anticipate the issues that are likely to be at the forefront of lenders' minds, consider whether they are likely to be controversial,

> When embarking on a new financing, it is helpful to anticipate the issues likely to be at the forefront of lenders' minds

and, if so, decide what the appropriate response may be.

As such issues often need to be considered and addressed on a case-by-case basis, the number of recent developments to be dealt with can have an impact on the time taken to settle the documentation – something that may need to be factored into the timetable and/or even the borrower's position on the relevant issue. To facilitate a smooth documentation process, borrowers may find it worthwhile to discuss the issues that are likely to arise with their legal advisers at an early stage in the transaction, with a view to assessing the lenders' or lead arrangers' likely views and current market practice in advance of detailed documentation discussions.

The guide highlights some of the more recent developments that are relevant to many current lending transactions.

Negative benchmark rates

Should a contractual floor of zero be imposed on Libor, Euribor or another applicable benchmark for the purposes of the agreement? The commercial point here is whether the lenders or the borrower (by virtue of a reduction in the margin) should have the benefit of a negative benchmark rate.

Benchmark reform

Reforms to Libor, Euribor and other benchmarks have prompted the LMA to make a number of changes to the provisions of its templates catering for the use of benchmarks and for the consequences of the non-availability of the chosen benchmark. These changes are, in the main, not controversial, but require focus, as they include a number of options. For example, the parties may choose whether to include or exclude the impact of any intraday refix of the relevant benchmark for the purposes of the agreement, and are provided with a choice of fallback rates to apply if the screen rate is unavailable.

Impact of sanction and anti-corruption laws

Lenders' compliance obligations in this regard have customarily been addressed in pre-contractual due diligence, but increasingly aggressive enforcement action by authorities around the world has prompted lenders over the past few years to seek contractual assurances on these topics from borrowers, to crystallise the results of their due diligence and to ensure no compliance issues arise over the life of the facilities. Lenders can take a range of views on the need for and scope of such provisions. It is true that, over time, lenders and borrowers have become more familiar with each other's concerns in relation to these provisions (as have their advisers, aware of the likely compromise positions), but, in the absence of a market-standard starting point, the detail of the drafting must be settled on a case-by-case basis and generally requires some negotiation.

IFRS 16, Leases

As treasurers will be aware, this represents a major alteration in approach to lease accounting, which companies using IFRS are required to adopt for accounting periods starting on or after 1 January 2019. The balance sheet recognition of operating lease commitments has the potential to affect a number of financial tests and ratios customarily used in loan documentation, which currently take into account only finance lease commitments. Examples include covenants that place limits on a group's indebtedness. The contractual solution is to 'freeze' existing provisions so that they are interpreted in accordance with current lease accounting standards; in other words, until renegotiated, any reference to lease commitments, where relevant, will include only lease commitments that are currently treated as finance leases. The LMA (following discussions with the ACT) has made some optional changes to its templates to address this issue, requiring the parties to discuss what the agreed position should be.

Brexit's effect on the FX markets is, in some cases, coming up in documentation discussions

Brexit

The impact Brexit may have on the financial sector, and therefore the loan market, is the risk factor that has probably received the most attention from loan market participants over the past 12 months, although the general conclusion in most cases is that no changes to documentation terms are required at this stage.

Areas of focus have included whether the terms of the LMA's syndicated loan documentation are sufficiently flexible to accommodate any post-Brexit restructuring of lenders' participations (in terms of the jurisdiction in which their participation is booked and managed); the impact of Brexit on dispute resolution clauses; and the popularity of submissions to the jurisdiction of the English courts (current market practice being underpinned by EU legislation). These issues continue to be discussed. Lenders and borrowers are keen to understand them, but whether any risks highlighted are likely to arise in practice remains to be seen. This is reflected in the LMA's response. It has produced some helpful guidance, but has not recommended any changes to its templates.

FX volatility

The prospect of Brexit may have had minimal effects so far on loan documentation, but its effect on the FX markets is, in some cases, coming up in documentation discussions. Currency movements can affect certain financial covenant calculations and also capacity under certain monetary or financial limits that are relatively common in loan agreements. For example, exceptions to restrictive covenants often take the form of baskets that are capped by reference to a monetary amount specified in a particular currency. Any arbitrary effects of exchange rate movements can be excluded by express contractual provision, but the appropriate solution tends to vary according to the borrower's circumstances.

Each of these issues is discussed in detail in the new guide, including the legal and regulatory background, and some of the ways in which these issues are currently being managed in practice.

Kathrine Meloni and **Stephen Powell**, of Slaughter and May, are authors of the ACT's new *Borrower's Guide to the Loan Market Association's Investment Grade Agreements*. The ACT and Slaughter and May created the guide to assist treasurers. Download it at www.treasurers.org/technical. Comments and suggestions for future content are welcome

THE REINVESTMENT DECISION

IN PART TWO IN A SERIES OF THREE ARTICLES, BEN WALTERS SETS OUT HIS VIEW ON HOW CORPORATES CAN CALCULATE THEIR REINVESTMENT LEVELS

It is commonly understood that you have to invest and achieve a return often far higher than the weighted average cost of capital (WACC) in order to meet the profit and growth targets markets expect. But how does that reconcile with corporate finance theory, which states any return greater than WACC adds value and should therefore be pursued? In last month's *Treasurer*, I introduced the bridge between these two perspectives, which I've called MWACC*.

MWACC is the internal hurdle rate for the firm. WACC is the external cost of capital to the firm; the return that investors require from the firm. Realising the strategic value external investors have assigned to the firm requires that the firm invests in projects where the return is greater than WACC whenever one or more of these conditions holds true:

1. The firm is perceived to have a strategic position that will lead to future value creation; or
2. There is a restriction on the new investments the firm can make either through capital, management time or horizon period.

Both of these are relatively simple inputs to estimate and, from these, along with an estimate of WACC, it is possible to calculate MWACC.

MWACC has three uses to a firm. First, I would argue that it is the correct hurdle rate for investment decisions by the firm. Second, it can be used to determine the correct reinvestment level. And third, it can be used to derive performance targets linked directly to value creation.

This article examines how it can be used to determine the correct level of reinvestment back into the business and how getting this right can maximise the value of the firm. This analysis is, I would argue, an absolutely critical factor in maximising the value of the firm, far more so, in fact, than the traditional approach of optimising WACC through the debt-equity ratio.

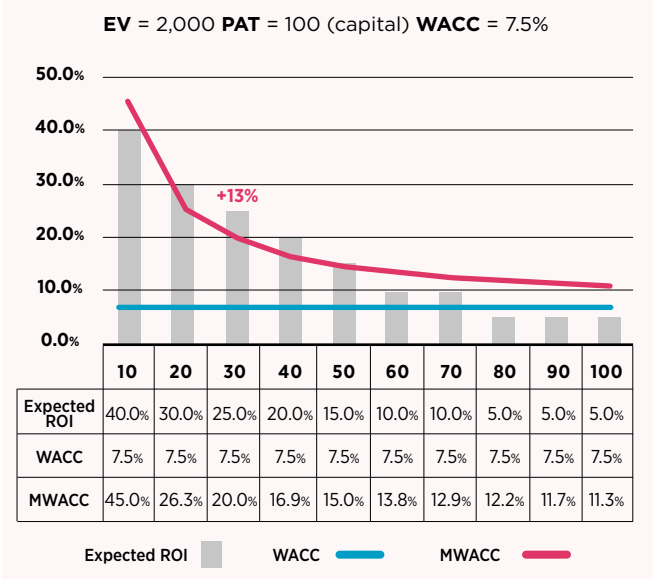
SHUTTERSTOCK

Reinvestment

It holds true in the real world that capital is a scarce resource. Firms only have their internally generated capital and a finite debt capacity to reinvest in normal circumstances. The less capital retained and reinvested, the higher MWACC becomes because the strategic value that investors have assigned to the firm must be created from a diminishing pot. Figure 1 (right) shows this for a notional firm A and also imposes the firm's estimate of its return on investment (ROI) at varying levels of reinvestment. For example, the first 10 units of capital invested cherry-picks projects with an ROI of 40%, but this drops away so that by the time capital of 80 is invested, the return is only 5% across the spectrum.

In order to maximise its value to investors, firm A is looking for the point at which its return gap (see box, below) is at its greatest. For firm A that point is at a reinvestment of 30 of its available capital of 100, even though ROI after this point up to a reinvestment level of 70 is still above WACC (also plotted). Capital invested from 40 to 70 is invested in projects that begin to dilute the return gap and the firm is better off returning cash to investors. Firm A should set its payout level at 70% of available capital and at this level, investor returns will beat WACC. This will lead, in theory, to an increase in enterprise value (EV) of 13% to the point at which these returns normalise against WACC.

FIGURE 1: Return on investment: firm A

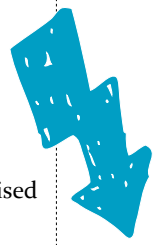


	10	20	30	40	50	60	70	80	90	100
Expected ROI	40.0%	30.0%	25.0%	20.0%	15.0%	10.0%	10.0%	5.0%	5.0%	5.0%
WACC	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
MWACC	45.0%	26.3%	20.0%	16.9%	15.0%	13.8%	12.9%	12.2%	11.7%	11.3%

MWACC plotted against ROI opportunities at varying levels of capital retained

Return gap

The answer to the reinvestment decision lies in the return gap between MWACC and the firm's internal assessment of its ROI profile. Maximising this return gap (if positive, ie firm A) or minimising it (if negative, ie firm B) optimises the value of the firm. The return gap is calculated as set out below:

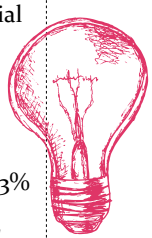


(ROI - MWACC) x capital invested = return gap

The return gap is optimised at the point at which the firm's returns from incremental investments begin to fall below WACC. For example, firm A at a reinvestment level of 30 has a return gap of:

(25% - 20%) x 30 = 1.5

If we make the simplifying assumptions that this return is a perpetuity and that firm A will be able to make this excess return every year into the future (another perpetuity) at a reinvestment level of 30, then the potential additional value this will generate over the current enterprise value is:



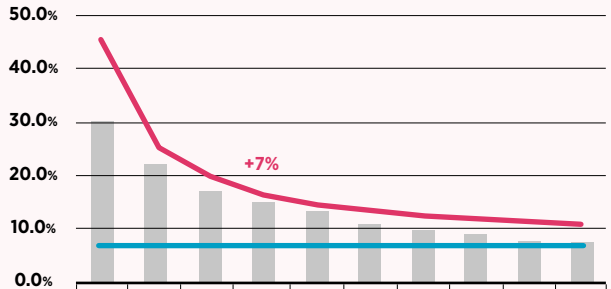
1.5 x (1/7.5%*) x (1/7.5%*) = 267 = an increase in EV of 13%

*7.5% being firm A's WACC

Firm B (see figure 2, above) has an identical EV, PAT (capital) and WACC as firm A, but it has a problem – it is unable to beat its MWACC at any level of capital reinvestment, even though it can make investments that beat WACC.

FIGURE 2: Return on investment: firm B

EV = 2,000 **PAT** = 100 (capital) **WACC** = 7.5%



	10	20	30	40	50	60	70	80	90	100
Expected ROI	30.0%	22.0%	17.0%	15.0%	13.0%	11.0%	10.0%	9.0%	8.0%	7.5%
WACC	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%
MWACC	45.0%	26.3%	20.0%	16.9%	15.0%	13.8%	12.9%	12.2%	11.7%	11.25%

Expected ROI WACC MWACC

Firm B is overvalued, but it can minimise the impact by reinvesting 40 of its available capital and returning the remaining 60 to investors

Firm B has investments across the spectrum of its capital available that are net present value positive (when discounted against WACC), but are negative versus MWACC. Firm B is overvalued because wherever it pitches its reinvestment level, it cannot generate enough value to justify its current EV of 2,000. However, the firm can minimise the loss to its investors by setting a reinvestment level of 40 and paying out the remaining 60 of capital to its investors.

Of course, no one is suggesting that you can be this precise in real life, but firm B's management has the information available to it, if it knows where to look, to set an optimum reinvestment level and minimise the loss of value to its investors.

Building the ROI profile

Firms rarely build an ROI profile across the spectrum of their available capital for reinvestment. This analysis though is critical to optimising the value of the firm. Although subjective and hard to measure (not least because it is a concept not likely to have been adopted before), any planning cycle should incorporate this analysis in order to support the payout and reinvestment decision. Overlay MWACC onto this profile and this type of analysis immediately adds insight into the optimal level of reinvestment, maximising investor returns and the value of the firm.

As with many applications of corporate finance theory to business decision-making, it is often not the detailed

calculations that drive out value, but the thought process that following these principles enforces. In this situation, aligning the budget and planning cycle to a consideration of how much the cash flows from the business would be expected to change at varying levels and helps to define the level of reinvestment and investor payout that maximises firm value.

In a world where constraints on investments exist and the firm is considered to have a strategic position of value, MWACC is always higher than WACC. MWACC should be used for all investment-appraisal decisions. In addition, considering MWACC against the ROI profile across the range of reinvest levels informs the firm of its optimal level of reinvestment and, by consequence, payout. This analysis is a critical element in maximising the value of the firm.

In the next article, we'll place MWACC at the heart of the way the firm measures internal performance, and in so doing align this to the value created or destroyed by management actions.

It holds true in the real world that capital is a scarce resource. Firms only have their internally generated capital and a finite debt capacity to reinvest in normal circumstances

Ben Walters is deputy treasurer at Compass Group. (*The term MWACC is trademarked to the author)

Funding UNLOCKED

SECURITISATION IS NO LONGER THE PRESERVE OF LARGE REGULATED ENTITIES. PERMJIT SINGH EXPLAINS HOW INNOVATIVE MODELS ARE BEING DEPLOYED TO THE BENEFIT OF INVESTMENT-STARVED SMEs

Securitisation – essentially the receipt of cash in exchange for assets by offering securities secured over those assets – is often seen as a complex, specialist area of corporate finance.

However, regulators are now increasingly embracing securitisation as the key to unlocking capital markets and banks, and channelling liquidity towards investment-starved companies and consumers across Europe, a trend set to prove especially beneficial to SMEs.

According to a report by the National Institute of Economic and Social Research, UK banks have historically provided around 93% of UK SMEs' external funding needs via loans, factoring, leasing and overdrafts. Just four of them provide 80% of all SME loans and 85% of SME current accounts. SMEs are therefore inextricably bound to banks, so the financial crisis that dragged many banks into financial distress, dragged many SMEs to the same fate.

The funding gap left by distressed banks is wide and deep, but new and alternative lenders are beginning to fill it. One new model, referred to variously as peer-to-peer, crowdfunding or marketplace lending, offers loans to mostly small SMEs and sole traders, from a multitude of mostly small investors through online lending platforms. And there are signs of this maturing. After several years, one UK platform (itself a fintech SME) recently refinanced £130m of its book of loans through the capital markets with a term securitisation, the first of its kind in Europe.

Another securitisation model – coordinated by the European Investment Fund – involves national aggregators in several EU countries (such as the British Business Bank) buying business loans off domestic commercial deals, and then seeking to refinance these loans through a conventional term securitisation.

Small-scale securitisation

In terms of mainstream securitisations, most deals are hundreds of millions of pounds in size each, and many are in the billions of pounds in scope. Deals of this size are impossible for relatively small non-financial companies, especially SMEs.

However, small-scale securitisation transactions have become a reality in the UK, and without compromising standards or funding outcomes, they're also a reality overseas.

One SME that is filling the lending gap left by banks recently securitised its loan book in exchange for £50m of funding to provide further loans to SMEs. Loans were provided to the SME and other underfunded SMEs by a central hub company, itself a SME.

To fund its intercompany loans, the hub issues listed and rated asset-backed securities (ABS) that are identical in many ways to ABS issued in conventional multibillion-pound securitisations. For example, they have a trustee, a calculation and paying agent and a registrar, and they're of a minimum denomination, rated and listed, so are of a standard where they are eligible for purchase by many regulated and capital-conscious institutional investors.

> Securitisation is an adaptable mechanism capable of serving the financing needs of all SMEs

IKON IMAGES

Using a multi-seller hub model achieves economies of scale, and each borrowing company avoids the infrastructure costs needed to issue ABS themselves. It might also attract a subgroup of institutional investors who do not demand deal sizes that many SMEs cannot achieve.

Importantly, many of the costs of securitisation are relatively low to begin with, making a multi-seller conduit model a practical and viable alternative to conventional big-sized term securitisation transactions.

Even though companies can now raise relatively small amounts of funds using the multi-seller conduit model, the minimum of around £5-10m might still be too large for some companies to deploy efficiently. For them, an alternative multi-seller model could be the solution.

Asset-backed commercial paper

In essence, these transactions involve issuing small-value securities on a revolving basis – when funds are needed, ie in amounts of a few hundreds of thousands of pounds instead of tens of millions of pounds.

This revolving small-scale multi-seller model illustrates that there is not just one model for securitisation. ABS investors buy short-dated small-value securities (asset-backed commercial paper) that complement longer-dated term ABS.

Some of the basic costs paid in the above models of securitisation could be excluded if they are too much for some SMEs – by issuing ABS into the unlisted and unrated securitisation market.

The pool of investors and liquidity in the unlisted and unrated ABS market will be significantly reduced as a result, but not totally. The standard of disclosure will be reduced, too, but if the ABS offer is marketed as a Financial Services and Markets Authority-compliant financial promotion, then investors will have the assurance that the information memorandum is fair, clear and not misleading.

In 2015, property developer Unihousing issued a £1m retail bond as a financial promotion (unlisted, unrated and transferable), secured over a student accommodation development site, and sold to corporate and retail investors. The apartments are now built, fully tenanted and student rent is servicing the interest on the bonds.

The bottom line is, securitisation is an adaptable mechanism that is capable of serving the financing needs of all SMEs.

Securitisation has almost always been discussed in the media and in academic circles from the perspective of banks and institutional investors. What is different now is regulators are discussing securitisation in a sincere effort to use it to enable SME funding.

After being misused in the run-up to the financial crisis, securitisation is undergoing a transformation with the aim of making it more accessible to SMEs and of restoring its reputation. It is an affordable, adaptable and effective mechanism for funding companies of all sizes.

SMEs, especially now, have the means to diversify their sources of funding and lower their reliance on currently unreliable bank finance. Regulatory and political frictions and tensions between the exiting UK and the EU, and within the EU regulatory and political hierarchy, must not scupper or delay this opportunity.

SMEs have the means to diversify their sources of funding

Permjit Singh is a former head of treasury for a company that securitised its assets through term and conduit securitisation structures

A FRESH PERSPECTIVE ON WORKING CAPITAL

UK BUSINESSES ARE COMING UNDER MOUNTING PRESSURE TO TIE UP WORKING CAPITAL. LLEWELYN MULLOOLY AND MARTIN FLINT EXAMINE THE DRIVERS BEHIND THIS TREND

SHUTTERSTOCK

Despite being a perennial concern for treasurers, working capital improvements often consist of short-term fixes. Yet the benefits of optimising working capital stretch far beyond small financial gains or year-end tactical actions. Approached in the right way, improving working capital can lead to a more efficient balance sheet and significant cross-functional process efficiencies.

Today, more and more companies are realising that working capital optimisation is a worthwhile long-term objective. What's more, they are looking to gain a better, real-time understanding of their own and their competitors' working capital.

Combining data from Markit Economics' Regional Purchasing Managers' Index (PMI) with forward-looking survey data from other sources, Lloyds Bank's new Working Capital Index enables consistent measurement and comparison of the drivers of working capital performance in the UK, as well as future expectations.

Pressure points

Several trends emerge when you look at these data together. The overarching trend, given robust revenue growth for UK corporates in the past year, is the sheer level of pressure being placed on these organisations to tie up more working capital, now at its highest level since before the financial crisis of 2008.

Indeed, our analysis shows that there is already an opportunity to release £498bn of working capital tied up in the cash cycles of plcs, based on historical performance for larger corporates or industry best practice for smaller companies.

One of the key drivers of this trend is the fact that UK businesses are now translating the uncertainty of the EU referendum result into tangible consequences. Among the companies surveyed for the Index, one in five said that the sterling exchange rate was their biggest working capital concern over the next 12 months.

Manufacturers have been particularly affected by post-referendum sterling weakness. Because of this, they have been forward-purchasing inputs and raw materials – in anticipation of price rises. In fact, data from the UK's Office for National Statistics released in January this year shows that such price increases are already very real, with input prices up 20.5% year-on-year.

As understandable as forward purchasing may be, this behaviour is pushing up inventory and, according to PMI data, the UK manufacturing sector had the highest build-up of it in six years. This is a large amount of inventory – that needs financing – sitting on the balance sheet, with reductions dependant on business output in 2017, or process-efficiency drives.

Conflicting priorities

Elsewhere, the unstable geopolitical and economic climate is leading some customers to look to lengthen their payment terms with UK businesses, again adding to the pressure on working capital. According to our findings, as many as one in four companies consider changes in customer payment terms as their top working capital concern over the coming year.

Finally, working capital is also being impacted by companies' own growth expectations. Despite operating against a backdrop of uncertainty,

As companies expand, they tend to focus less on process efficiencies and more on margins

revenue/output has been relatively robust since the EU referendum. This may be in part due to weaker sterling, which has improved the competitiveness of exports, boosting revenues for exporters. As such, many British businesses are in fact expecting growth in the year ahead.

The downside is that growth naturally exerts pressure on working capital. As companies expand, they tend to focus less on process efficiencies and more on margins and increases in revenue. The risk is that rising input costs can squeeze margins, in turn putting pressure on cash flow, particularly where longer terms have been used to facilitate trade.

At the same time, however, a sustained depreciation of the pound is also leading to inflation, which can lower domestic demand. Historical analysis of the Working Capital Index against the trade-weighted exchange rate shows that, after prolonged periods of depreciation in the pound, UK firms tend to intensify their efforts on reducing working capital to improve balance-sheet efficiency and support cash flow.

Practical steps

With this in mind, treasurers will no doubt be wondering how best to prevent any deterioration in the efficiency of their working capital management going forward.

One of the main challenges is that, although treasurers often have ultimate responsibility for managing working capital, they do not have complete control over it. Cross-functional collaboration between treasury, procurement and sales is therefore vital to any successful working capital optimisation initiative.

Ideally, this collaborative approach should be handed down from senior management, with clear objectives and accountabilities for working capital management and robust management information, including key performance indicators (KPIs). Sharing management information on a cross-functional basis can also be hugely beneficial, giving all participants visibility over the working capital cycle. For example, sales and credit teams can improve working practices by regularly sharing information on sales campaigns and targets, as well as providing information on customer payment performance, overdue receivables and disputes, or customers approaching agreed credit limits.

Moreover, reporting should help other functions to understand the knock-on effect of their actions – and that there is a risk of creating greater inefficiency in the company's working capital management if other business areas act independently from each other, as well as treasury and finance.

This understanding can be further enhanced through targeted training. Working capital management education sessions, perhaps run by treasury, could, for example, highlight to procurement teams that there is an additional working capital cost for holding inventory, which may in fact offset some of the price benefits of forward purchasing. Equally, sales teams often do not fully appreciate the working capital impacts of agreeing to longer customer credit periods simply to win new business.

If treasury is still struggling to achieve cross-functional buy-in to working capital optimisation, a clear business case that outlines the benefits for each function and its respective stakeholders may be effective. Alternatively, incentives tied to working capital KPIs may prove fruitful.

Greater transparency

As well as cross-functional cooperation and visibility, it is important to have the right level of management information to help drive improvements across each of the individual areas of payables, receivables and inventory, too.

Equipped with that information, it should be possible to pinpoint sources of inefficiency and potential opportunity in each cycle, and seek out sustainable solutions. Interestingly, payables are one area that UK companies are likely to be examining much more closely in view of the Payment Practices Regulation, which obliges large corporates to report on their payment practice and performance, with some due to start reporting by the end of 2017.

Given the level of transparency that the legislation brings over supplier payments and payment terms, large businesses are using this information to help optimise their working capital by reviewing their legacy payment processes and weeding out internal inefficiencies. Many companies are also seeking ways to lengthen their days payable outstanding without negatively impacting suppliers. As such, more businesses are recognising the potential of solutions such as supplier finance, in combination with internal efficiency drives.

As for receivables, despite the move towards greater payment practice transparency, many customers are still likely to use the current market uncertainty as a trigger to extend their payment terms. The challenge for treasurers is how to balance those longer payment terms against lower margins resulting from increased input costs. Corporates will likely therefore be looking for ways to accelerate cash, perhaps through early-payment discounts or use of factoring arrangements. However, longer-term automation and improvements in the fulfilment, invoicing and collections process, are also likely to gain more traction as we look ahead.

Similarly, quick wins will not deliver lasting solutions to inventory challenges. Sustainable improvements require a review of the company's end-to-end inventory processes, including stock-management systems and linking this to customer service levels. In the longer term, it is likely that this will lead to ever closer and better working relationships with customers and suppliers.

Llewelyn Mullooly (left) and **Martin Flint** (right) are both directors of working capital at Lloyds Bank. To find out more about Lloyds Bank's Working Capital Index, visit lloydsbank.com/workingcapital

LLOYDS BANK

THE POWER OF THE NETWORK

FINANCE PROFESSIONALS AND TREASURERS HAVE BEEN HESITANT WHEN IT COMES TO ADOPTING SOCIAL MEDIA. HERE, MARTIN BELLIN OFFERS A PERSONAL VIEW OF ITS POTENTIAL BENEFITS FOR COLLABORATIVE WORKING

Over the past decade, social media has profoundly changed the way in which people communicate. Most of us use social media every day. According to Statista, a statistics, market research and business intelligence provider, the power of social networking is such that the number of worldwide users is expected to reach some 2.95 billion by 2020, around a third of Earth's entire population. The same goes for businesses: marketing or sales teams have long adopted channels such as LinkedIn, Twitter or even Facebook for their purposes. But social media and treasury? Traditionally, finance professionals have been a bit more reluctant to venture into the social media realm – whether it be for security reasons or because they fear reputational damage in what is a traditionally fairly conservative industry. If social media is used at all, it is often more for personal or career reasons.

So, why should this hesitancy towards the use of social media in a professional setting disappear anytime soon? Because the world in general, and the business world specifically, is changing rapidly, and we have been seeing a general trend towards the distribution of both work and data. Just think of blockchain. It is all about real-time information, about connecting and finding the right networks. More and more finance practitioners have been embracing mass communication and social media for various reasons. First and foremost, networks provide information and insights, and allow access to like-minded people. They can serve as support networks and enable what is sometimes referred to as 'information equity' – asking a question and having a whole network respond. And these benefits are by no means limited to a personal setting.

We have been seeing a trend towards the distribution of both work and data

Social treasury

How can networking and social media add value to treasury? In the same way they do in our everyday lives: by putting us in touch with the relevant people and by presenting a veritable goldmine of information. Wouldn't it be nice to keep up to date with the latest trends in treasury or with

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developments in the industry via the fast and efficient social media channels that we already use for so many other aspects of our lives? Or how helpful would it be if you were to connect to a new bank in a somewhat more 'exotic' country and you had access to a large network of corporate treasurers, some of whom may have successfully done exactly that a while ago? The combined know-how and the tips and tricks you can draw from such a network are invaluable – especially in a world where regulations and market specifics have made local knowledge more important than ever.

This is not some abstract treasury dream: Twitter, LinkedIn and Facebook are dynamic spaces that give access to background information and breaking news, allow you to follow and be followed, and engage in discussion – and this in a much more global, accessible and immediate fashion than traditional communication tools, such as email, ever could. It is not unusual for treasurers to work entirely solo or at least work in a comparatively small team. Arguably, technological advancements and automation are going to exacerbate this situation even further. Thanks to social networks and communication, even the 'one-man shows' can get connected and be in touch with industry peers.

By integrating social media tools and networks into their daily workflows, treasurers can gain access to a host of information and support, and leverage these tools in the interest of fast, efficient and succinct information.

> It seems logical to leverage the often fast-paced and immediate nature of social media and mass communication

Treasurers' role

After all, the role of the treasurer has changed dramatically since the financial crisis. Treasurers have become much more prominent players within their organisations, and embracing modern communication to carry this new-found clout into a more general ether is the logical next step. Corporate management depends on treasurers like never before, and social media platforms are a powerful means of delivering messages and of living up to this status by being visible and by joining forces. These platforms provide both scale and reach to disseminate information and to listen to what others have to say. The finance industry and the treasury profession and tools have been changing so rapidly, it only seems logical to leverage the often fast-paced and immediate nature of social media and mass communication.

So what about technological advancement? Hasn't this been the driving factor behind corporate treasury's journey into the new century? No one can deny that treasury technology has come a long way in the past few years. However, technology is ultimately a means to an end. Users are result-oriented and care little about the underlying technology. They don't want to waste their time and energy on understanding how a system works; they want the system to deliver. This is why, in the long run, technology will take a back seat, and global networks will become more and more important.

Up to date and in touch

How can we make the most of this trend? The ultimate goal must be to combine technology and the valuable experience of using social media in the most efficient way. It is of course possible to take these new trends into consideration and incorporate social media features into a TMS by means of an integrated Twitter feed, for instance. It has become more important than ever to be in touch with your industry peers, and we believe that this should include providers. A treasury provider should be accessible and listen to what users have to say – and what better way to achieve this than the straightforward and empowering communication channels of global online networking?

Social media and mass communication have become an integral part of a globalised, modern business world, and corporate treasury is no exception. So while there might still be some hesitancy, more and more treasurers have recognised the potential and are embracing these new tools. This is a powerful and efficient new approach, and, correctly used, social treasury can add real value to corporate treasury.

Martin Bellin is the founder and managing director of BELLIN Group

FIXING STRATEGIES CAN PROTECT INTEREST INCOME AND EXPENDITURE AGAINST UNFAVOURABLE MARKET RATES, ALTHOUGH WE MAY COME TO REGRET LOCKING IN. DOUG WILLIAMSON EXPLAINS

THE RISK OF REGRET

Many treasury risks arise from volatile market prices. To hedge this type of risk in practice, many treasurers use fixing derivatives.

One example is a forward rate agreement (FRA). Let's apply this learning to a practical case study, using an FRA to protect interest income. Of course, the same principles apply when using other fixing derivatives (for example, FX forwards) to hedge other market risks (for example, currency risk).

FRA tops up interest income

Depositors fear low market interest rates. Low rates mean less income. An appropriate FRA can provide a welcome top-up should actual (short-term) interest rates turn out to be lower than previously expected, effectively fixing a hedged rate of income.

We are AmericaWatches (AW), a US-headquartered group. AW has agreed to sell a subsidiary for a large sum in US dollars. We expect to receive the sale proceeds in three months' time. We've decided to invest the proceeds in a fixed deposit for six months, starting in three months' time.

AW's concern is falling interest rates, reducing interest income. An appropriate FRA would pay AW cash compensation if interest rates were to fall, as feared.

Fixing derivative
Fixing derivative instruments, such as FRAs, hedge an exposure to a market price, by effectively fixing a hedged market price or rate. The derivative instrument is a separate contract from any underlying exposure being hedged.
Counterparty
The other party to a derivative contract is known as the counterparty.

FRA priced at 1.6%

Accordingly, AW takes out an appropriate FRA, priced at 1.6%. The FRA counterparty will pay AW compensation, based on any shortfall between the market reference rate and the FRA rate of 1.6%. Conversely, AW must pay the FRA counterparty if the relevant market interest rate is above 1.6%.

To keep our example simple, assume AW deposits the sale proceeds at the market reference rate.

Market rate 1%

If the market rate turns out to be 1%, this is the low rate AW earns from its deposit in the market. This is the situation we feared. Interest income, before hedging,

has fallen. However, compensation is received from the FRA.

The FRA will pay AW the difference between the FRA rate of 1.6% and the market rate of 1%. This is 0.6%, nicely topping up AW's interest income. Total hedged income will be 1 + 0.6 = 1.6%.

Market rates bad: better hedged

Without the FRA, AW would only have received the market rate of 1%. As depositors, we're better off with our FRA. Hedged interest income is fully protected against any falls in the market rate.

Market rate received (%)	Add: received from FRA v 1.6%	= Hedged income (%)
1.5	0.1	**1.6**
1.0	0.6	**1.6**
0.5	1.1	**1.6**

Separate contract: different counterparty

Remember, the FRA is a separate contract from the deposit. Indeed, the FRA is normally with a different counterparty. The rights and obligations under the FRA don't depend on the deposit. They are two separate deals.

Where's the catch?

The FRA seems too good to be true. It pays out exactly the top-up amounts of money needed. Who's paying for this wonderful benefit?

In financial markets, if you don't understand who pays for something, it's usually you. AW has obligations under this FRA, as well as rights.

FRA obligations

The main obligation is to pay the FRA counterparty if the market rate goes in the other direction. Here, AW must pay the FRA counterparty any excess of the market rate, over the FRA rate of 1.6%. The net result is that AW's hedged income achieved is still 1.6%.

Market rate received (%)	Less: PAID under FRA v 1.6%	= Hedged income (%)
2.0	(0.4)	**1.6**
2.5	(0.9)	**1.6**
3.0	(1.4)	**1.6**

*Answer: Paid under FRA 0.8% + 1% market rate payable = 1.8%

When market rates go up in this situation, a depositor is worse off with the FRA. With hindsight, as depositors, we'd have got more net income if we hadn't hedged.

Can't we get out of it?

Sorry, no. If that were allowed, FRA counterparties would never make any money. No one would make a market in FRAs.

This situation, of wishing that we hadn't committed to a fixed rate, is known as an 'opportunity loss', or 'opportunity cost'. We're locked in, losing the flexibility to take advantage of better market rates.

The only way to enjoy protection against unfavourable rates, while still retaining flexibility, is to buy an option. However, options bring their own risks and costs, usually including an upfront premium.

Can derivatives hedge expenses, too?

They certainly can. However, as we'll see, the price of the derivative will be worse for the customer. Let's take another practical interest rate example, this time hedging interest expense.

Say BorrowCo needs to draw down a loan in three months' time, for a six-month period, to be priced at the prevailing market rate in three months' time.

What's BorrowCo worried about?

BorrowCo's concern is that market rates might go up, making the borrowing more expensive. Happily, BorrowCo can take out an FRA to hedge this risk.

The cash flows of BorrowCo's FRA, hedging interest expense, are in the opposite direction from the FRA that AW used earlier, to hedge its interest income. Naturally, the pricing will be worse for the customer, say 1.8% here.

FRA to hedge borrowing, 1.8%

If the market rate goes up, the FRA counterparty compensates the borrower. BorrowCo receives any excess of the market rate over the FRA rate of 1.8%. Making the simplifying assumption that we borrow at the market reference rate, our hedged interest expense is now effectively fixed at the FRA rate.

Market rate paid (%)	Less: received from FRA v 1.8%	= Hedged COST (%)
2.0	(0.2)	**1.8**
2.5	(0.7)	**1.8**
3.0	(1.2)	**1.8**

High rates are bad news for borrowers. Without the FRA, we'd have suffered the full market rate payable, without any compensation. As a borrower, BorrowCo is better off with the FRA, when market rates go up.

Your turn

Continuing BorrowCo's case study, identify the hedged interest expense achieved if the market rate turns out to be 1.0%.

Learning strategies

We've seen that a fixing strategy for hedging, while giving a company greater certainty about the rate that will be realised on an exposure, always risks opportunity losses. By contrast, applying a continuous learning strategy has no significant downside. You are guaranteed to add value to your organisation and career.

(Check your answer.)*

With thanks to Paul Cowdell and Jonathan Jeffery for their valued suggestions.

Doug Williamson is a finance and treasury coach

JEEVES AND THE CORPORATE TREASURY

What every good IPO needs is a steady hand at the tiller. Particularly when the CFO's hand is less than steady

SHUTTERSTOCK

"Jeeves!" I ballyhooed, as I returned to the domestic fold at Berkeley Mansions. "Sally forth and bend me your ears for momentous news!"

My valet, Jeeves, is never more than a gnat's wing afar when he is summonsed, and this occasion was no exception to that rule. I daresay he not only sallied forth, but sallied fifth, sixth and seventh, as well. A large glass of one of Jeeves' restorative bracers was instantly at my elbow and not long for this world.

"Lend, sir," said Jeeves.

I was taken rather aback. "'Lend, sir'? Now listen, Jeeves, Bertram Wooster is a friend indeed to any good man in need, but I'm not sure I take to this ordering about from you to provide temporary financial assistance."

"I'm sorry, sir, you misunderstand me. The phrase is, 'Lend me your ears', not 'Bend me your ears'."

"Ah! Got it!" I said. "Well, that's another financial thing I'll have to know all about, this 'lending of ears' business."

"Another financial thing, sir?"

"Indeed! For this is my momentous news. The Drones Club is to become what is known as a 'plc' and to make itself available to all honest seekers of fortune on the stock market. We are to do what I'm told is an IPO, Jeeves."

A second's pause and the driest of coughs, and Jeeves asked, "Is that entirely wise, sir?"

"Absolutely!" I insisted, putting my foot down and my hand out for a medicinal refill.

"May I enquire as to who will be on the board of management of said enterprise?" asked Jeeves, as he swapped an empty glass for a full one.

"It's true that not all the i's have been dotted and there may be an uncrossed t or two. For one thing, Gussie Fink-Nottle and Oofy Prosser couldn't decide who should be CEO and who should be chairman," I explained.

"And how was that particular sixes-and-sevens conundrum resolved, sir?" Jeeves enquired.

"We don't know yet," I said. "Truth be told, they settled the matter in a drinking competition and neither of them has been seen since. But the best bit is that I'm to be the chief financial wotsit!"

A second second's pause and an even drier cough, and Jeeves asked, "Is that entirely wise, sir?"

"*Carpe diem*, Jeeves! That's Latin for The Day of the Goldfish."

"Perhaps, sir, I might offer you my services as the corporate treasurer," said Jeeves.

This sounded like he might be on to something. There isn't a Rolls-Royce on the road with a glove box big enough to house Jeeves' brain. While the Woosters store up charm, wit and general bonhomie, the Jeeves personae (if personae is the word I'm looking for) can take apart a situation, analyse it until it apologises for having troubled you, and then put the whole lot back together again.

"Just one thing," I enquired. "What exactly is a corporate treasurer?"

"A corporate treasurer is to a CFO what a gentleman's gentleman is to a gentleman," said Jeeves. "The soul of discretion, the provider of counsel, the trusted cash handler, the one who keeps the CFO out the soup, as it were. The priority is numeracy over notoriety. The Drones Club board of management wouldn't even know I'm there."

"Sounds like you've landed the job," I said.

"Thank you," said Jeeves.

"No, thank you, Jeeves."

Andrew Sawers is a freelance business and financial journalist. He is a former editor of *Financial Director* and has worked on *Accountancy Age*, *Business Age* and *Commercial Lawyer*. He tweets as @Mr_Numbers

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The highlights of the May 2017 issue of *The Treasurer* include: Webcor Group's head of treasury, Mona Lockett, on cash visibility and the challenges of centralising treasury, on page 18. A group of treasurers share their views on the software and systems approaches they rate the highest, on page 22. A guide on training programmes and how to teach, on page 26. What are the benefits of using social media in a treasury environment? Find out on page 42

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