

WHITE-COLLAR CRIME

Bribery, corruption and what to do in the event of a breach

DOING BUSINESS IN IRAQ

Harsh economic realities and even harsher logistics

CASH FORECASTING

Optimal solutions for cash-forecasting woes

The Treasurer

THE MAGAZINE OF THE ASSOCIATION OF CORPORATE TREASURERS ◆ NOVEMBER 2015



Who is keeping watch over your data?

The growing realities of cybercrime

PLUS

PEDRO MADEIRA

Group treasurer at Thames Tideway Tunnel on building treasury from the ground up



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LEADING TREASURY PROFESSIONALS



Editor's letter

You will have seen from our cover that *The Treasurer* looks this month at the dark arts, or, in language more familiar to the corporate world, cybersecurity.

Commentators are describing the attack last month on telecoms group TalkTalk as a wake-up call, a warning that corporates are now hugely at risk of near-inevitable, large-scale hacks resulting perhaps not in immediate financial loss, but ransom demands, to say nothing of massive hits to their reputations.

The attack, thought initially to be the work of a criminal gang using techniques well known among hackers, is now laid at the door – somewhat incredibly – of a 15-year-old boy, who, it is alleged, accessed the details of up to four million customers.

In our feature on page 18, business and finance journalist Christian Doherty spells out the problem. Holding payment card details and processing card transactions is undoubtedly a risky business, but the trend towards extortion attempts cannot be ignored any longer.

Survey after survey – and we highlight one in our briefing pages on page 8 – have warned that organisations do not take their cybersecurity sufficiently seriously. As well as ransom demands, carefully researched forged emails from senior executives that appear to authorise wire transfers, so-called spear phishing, are a growing problem. These are no longer theoretical risks or occasional incidents on the periphery. They are mainstream and need to be taken as a given. Take a look at our feature for an assessment of where treasury should be involved.

Given the potential scale of these incidents, along with the need to negotiate all the other challenges that the business world throws at us, it is perhaps time organisations looked at the collective resilience of their people. Whether to help employees address operational setbacks, M&As or their greater corporate governance responsibilities, resilience is becoming the issue of the moment among HR departments and executives. Turn to page 42 for a piece by Geetu Bharwaney, business coach and author, on how to cultivate it.

On page 24, Ben Poole profiles Pedro Madeira, who, as group treasurer of Thames Tideway Tunnel, has been given the fascinating task of creating a treasury function from scratch.

We look at emerging markets, too, in this issue. On page 30, for instance, we have an account of the realities of doing business in the post-war fragility that is Iraq. Harsh economic realities and security issues don't come any more basic than this.

I hope you enjoy the issue.

Liz Loxton

editor@treasurers.org
Follow us on Twitter @thetreasurermag



THIS MONTH'S CONTRIBUTORS



Christian Doherty is an experienced freelance business and finance journalist. He writes widely on management

issues, accountancy, regulation and capital markets for a range of publications. His article in this issue of *The Treasurer* on trends in cyberattacks appears on **page 18**



Ben Poole is a freelance treasury journalist and editor, who specialises in writing on corporate finance and transaction banking. In this

issue, he profiles Pedro Madeira, who came to the role of group treasurer of Thames Tideway Tunnel via Shell and Heathrow Airport, on **page 24**



Geetu Bharwaney has 25 years' experience of coaching leaders and executives. Her book, *Emotional Resilience: Know*

what it takes to be agile, adaptable and perform at your best, provides a framework for developing individual and team resilience. Her article on the subject is on **page 42**

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The Association of Corporate Treasurers
68 King William Street, London EC4N 7DZ
United Kingdom
♦ +44 (0)20 7847 2540
♦ +44 (0)20 7374 8744
♦ enquiries@treasurers.org
♦ www.treasurers.org

Engagement director Peter Matza
Policy and technical Steve Baseby,
Michelle Price
Sponsorship director Denis Murphy

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For all enquiries, contact Tom Fountain
♦ +44 (0)20 3771 7250
♦ tom.fountain@thinkpublishing.co.uk
or Dan Gallagher
♦ +44 (0)20 3771 7244
♦ dan.gallagher@thinkpublishing.co.uk

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Editor Liz Loxton

Managing editor Rica Dearman

Art editor Finn Lewis

Cover illustration Matt Murphy

Group account director Jackie Scully

Managing director Polly Arnold

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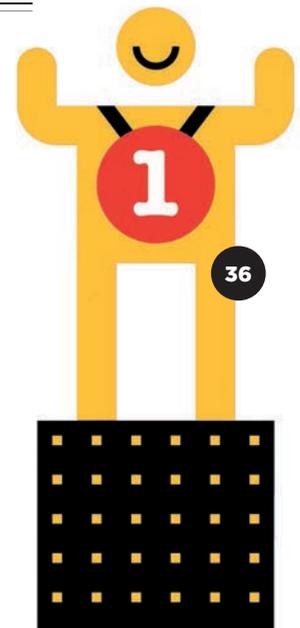
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L O N D O N



Agenda



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WORDS



BLOOMBERG/GETTY IMAGES

“I don’t want to cause pain to anyone. In fact that’s the tragedy. The pain was the result of trying hard not to cause the pain.”

UBS rogue trader Kweku Adoboli (pictured above) expresses his remorse for the unauthorised trading that resulted in a \$2.3bn loss for the bank.

SOURCE: FT WEEKEND MAGAZINE
24 OCTOBER 2015

“The greater the bailouts given by eurozone governments to their banks, the faster those economies deteriorated, exposing them and the public to greater sovereign risk.”

Dr Renatas Kizys, economist at the University of Portsmouth, on research findings suggesting that bailouts of banks only fan the flames of economic unravelling.

SOURCE: THE JOURNAL OF INTERNATIONAL FINANCIAL MARKETS, INSTITUTIONS AND MONEY, AUTUMN 2015

{ CONTEXT OF TREASURY }

UK MAKES PROGRESS TOWARDS CASHLESS SOCIETY

> The UK’s payment industry trade association Payment UK has said that payments will rise by 3.4 billion over the next decade to reach a huge 44 billion payments in 2024.

The acceleration will be driven by card, online and mobile-banking transactions, according to the association’s industry study: *UK Payment Markets 2015*.

Next year, non-cash payments by consumers are expected to eclipse the volume of payments by cash for the first time. Taking consumer and business payments together, non-cash payments overtook cash payments in July last year.

Debit and credit cards accounted for 51% of the volume of non-cash payments in 2014. By 2024, they are expected to account for 60% of non-cash payments. The volume of debit card payments is expected to grow from 9.2 billion in 2014 to 16 billion in 2024.

“In terms of percentage growth in payment volumes, the strongest growth over the next 10 years will be experienced by one-off automated credits process through the Faster Payments Service, which is forecast to almost double by 2024,” according to the report.

The overall value of cash withdrawn via ATMs, which

will still be the primary method whereby consumers acquire cash over the next decade, is expected to peak at £196bn in 2019 and start to decline slowly to £192bn in 2024.

Meanwhile, Sweden is on track to become the world’s first cashless society, according to a study from Stockholm’s KTH Royal Institute of Technology.

The institute’s research puts the trend down to a high take-up of technology and a crackdown on money-laundering activities in Sweden. Currently, cards are used routinely for even very small purchases, and there are fewer than SEK 80bn in circulation in total.

{ QUESTIONS YOUR FD IS LIKELY TO ASK THIS MONTH }

BASE EROSION AND PROFIT SHIFTING

So the OECD has finally come out with its final version of BEPS. All we need to do now is to tick the boxes and then wait for a quieter life on that front, surely?

Not really. One study, from law firm Allen & Overy, says that nearly eight out of 10 UK corporates have admitted that their approach to tax-planning conflicts with HMRC expectations and that corporates face significant challenges when it comes to striking the right note on their future tax planning.

The HMRC? I thought this was an international issue.

It is, and we shouldn’t forget the big picture. The Organisation for Economic Co-operation and Development (OECD) has estimated

that between \$100bn and \$240bn is lost in tax revenue due to what it regards as unacceptable tax practices. That’s the equivalent, it says, of 4% to 10% of global income tax revenues. But while the OECD has been advocating a coordinated international effort to cutting down on what it sees as tax avoidance, individual legislatures and tax authorities are the ones who need to run with the ball. Additionally, the UK has, as you know, acted unilaterally with the introduction of the Diverted Profit Tax regime in June’s Budget.

So, who else is likely to weigh in?

Well, the same study found that three-quarters of their respondents said their investors are becoming increasingly vocal on this front, with

77% registering demands for more information on tax matters. And BEPS is not the only change to tax law. There is an increasing number of international initiatives to take account of: the financial transaction tax and the Foreign Account Tax Compliance Act among them, as well as a growing number of general anti-avoidance rules.

Tax is moving up the agenda again?

Certainly, and that brings an increasing workload on the information-gathering front. Tax and treasury departments will need to work closely to provide each other with the required information, and will need a top-down plan to drive implementation of these new measures.

79%

respondents that have, at best, a basic understanding of their exposure to cyberthreats

43%

have yet to identify one or more cyber scenarios that could affect their organisations

33%

out of those that have done so, the proportion that has identified sources of funding that may be required in the event of a cyberattack



68%

have not estimated the financial impact of a cyberattack

77%

do not assess customers or suppliers they trade with for cyber risk

“China hopes to see a prosperous Europe and a united EU, and hopes Britain, as an important member of the EU, can play an even more positive and constructive role in promoting the deepening development of China-EU ties.”

A China foreign ministry statement reinforcing president Xi Jinping’s urging to prime minister David Cameron to remain within the EU.



What do you say? Tweet us @thetreasurermag

{ CONTEXT OF TREASURY }

Bank boards lack IT clout, survey finds

> Almost half the world’s banks have no directors with any relevant experience of technology on their boards, even though fintech start-ups and cybersecurity issues present considerable potential to disrupt the traditional banking operations.

And while global investment in financial technology more than trebled in 2014 to \$12bn, research for Accenture found just 6% of the bosses of the largest institutions had any technology experience at all.

The study of 109 global banks assessed how many directors had either senior technology experience at a company working as a CIO or worked as a non-executive director at a technology business.

The US and UK scored best in terms of the proportion of directors with relevant technology experience – notching up 15.7% and 14.3% respectively, according to Accenture’s report.

French banks reported just 3%, while banks in Spain and Switzerland had less than 7%. Italian, Greek and Russian banks failed to register a single



director with any relevant experience of technology.

Accenture’s head of financial services, Richard Lumb, told the *Financial Times* that banks needed to establish technology committees that involved board members.

Just 11% of US and UK banks have done this to date, while others are thought to be preparing to appoint leading technology figures, which has been complicated by the lack of suitably qualified directors.

{ CONTEXT OF TREASURY }

REGULATORS SAY BANK CONDUCT IS NEW FOCUS

> Britain’s financial services market is emerging from the shadows of the 2008 global crisis, as regulators move on from mopping up the fallout to improving the industry’s wider conduct.

A raft of recent speeches has seen authorities play down talk of further increases to capital requirements – the crucial buffers or reserves held in case of a future crisis. Instead, much of the messaging from regulators has been around how to improve the incentives for good behaviour within banks.

Andrew Bailey, CEO of the Prudential Regulatory Authority, now says there are “more important things to do” than forcing banks to further bolster their reserves.

Speaking to a City audience at Mansion House last month, Bailey said that the industry had already done much to strengthen the resilience of the global banking system.

Meanwhile, Tracey McDermott, the acting chief executive of City watchdog the Financial Conduct Authority (FCA), told the Mansion House Banquet that emergency measures needed to stabilise the financial system after the great crisis were now giving way to a more “sustainable approach to regulation, which breaks the regulate, deregulate, repeat cycle”.

The FCA was conscious, McDermott said, that bank boards were complaining of spending the majority of their time on regulatory affairs, which “cannot be in anyone’s interests”.



15% – the rate of increase in the amount of currency in circulation each year in South Korea

1% – the percentage of the global adult population holding 50% of global wealth, according to analysis from Credit Suisse

\$5trn – the combined market capitalisation of 81 businesses that have signed president Obama’s accord to take aggressive action on climate change

\$6bn – the amount paid to a hedge fund as a result of a ‘fat finger error’ on at Deutsche Bank’s London FX desk. The funds were repaid the next day

6.9% – the better-than-expected stated growth in Chinese GDP for the third quarter of 2015, according to the China’s National Bureau of Statistics

£34bn – or 6.4% – the UK tax gap or difference between the amount of tax that should be paid to HMRC vs what is actually paid, which is the lowest figure for nine years

{ KEY FINDINGS FROM THE INTERNATIONAL CAPITAL MARKET ASSOCIATION'S
29TH SURVEY OF THE EUROPEAN REPO MARKET }

€5,612bn – the total size of the outstanding repo business market on 10 June 2015 – the baseline set for the survey

2% – the increase on the headline figure of €5,500bn recorded during the previous survey in December 2014

10% – the share of tri-party repo compared with 10.5% reported during the previous half-year

2.9% – the decline from the €5,782bn baseline number posted a year earlier for the survey in June 2014

77% – the share of all government bonds within the pool of EU-originated fixed-income collateral reported in the survey



{ CORPORATE FINANCIAL
MANAGEMENT }

EUROPEAN REPO MARKET SLOWS

Europe's €5 trillion-plus repo business is failing to keep pace with underlying market trends, according to the International Capital Markets Association (ICMA).

The total amount of repo outstanding at 10 June 2015 was €5,612bn, according to the 29th biannual survey from the association's European Repo Council.

That was up just 2% from the headline figure of €5,500bn in December 2014 and 2.9% lower than the market size of €5,782bn a year earlier in June 2014.

The survey is billed as one of the only authoritative indicators of market size and structure as well as dominant trends.

Godfried De Vidts, chairman of the ICMA European Repo Council, said: "The stability of the headline figure over the past few surveys does not tell the full story. The repo market in Europe is not growing in line with underlying conditions.

"Increased bond issuance, extraordinary excess liquidity from LTROs [long-term refinancing operations] and QE [quantitative easing] and increasing demand for collateral driven by regulation might reasonably have been expected to produce an increase in repo trading."

De Vidts added: "The secured financing business is already facing significant pressure as the implementation of regulatory initiatives, such as the leverage ratio, net stable funding ratio, central securities depositories regulation and Bank Recovery and Resolution Directive, begin to bite."

The ICMA study on the share of directly negotiated transactions increased further, continuing a trend that began in 2012 and reflecting a shift away from low-margin interbank, commoditised and electronic transactions towards customer and customised business.

Additionally, domestic repo continued its long-term decline, probably reflecting the restructuring of the European business in the face of regulatory and other challenges.

The share of tri-party repo fell back, while there was also a drop in the share of all government bonds within the pool of EU-originated fixed-income collateral.

A further study on repo in Europe, to be released shortly, will provide greater insight into the changes in underlying these aggregated figures, De Vidts said.

{ AROUND THE WORLD IN 30 DAYS }

FIAT AND STARBUCKS TO REPAY TAX

Fiat and Starbucks have been ordered to repay €30m in tax after the EU competition commissioner ruled they had received illegal sweetheart deals in Luxembourg and the Netherlands. The move by commissioner Margrethe Vestager has been regarded as an effort to set a legal precedent by determining that such deals represent unlawful state aid, amounting to subsidies that must be clawed back. US technology giants Apple and Amazon are also under scrutiny over similar deals in Ireland and Luxembourg. Many hundreds of similar arrangements are in place across Europe and could all be open to investigation. "Paying one's fair share of tax should be firmly integrated in a company's corporate social responsibility," Vestager has said.

US regulator probes high-frequency trading

The US Commodity Futures Trading Commission (CFTC) is to investigate the impact of high-frequency trading, including how to minimise potential market disruption from 'malfunctioning algorithms'. Timothy Massad, head of the CFTC,



Starbucks is one of the firms ordered to repay tax

has signalled the first major effort to curb high-speed trading in the futures market amid fears about the level of influence electronic trading has on asset prices for shares, commodities and government bonds. Regulators have become increasingly concerned about large and volatile price movements – so-called flash events – that have been experienced in global markets and are often blamed on computerised trading.

China issues renminbi debt in London

The People's Bank of China attracted orders of more than ¥30bn (\$4.7bn) for its

first issue of government debt in its own currency in London. London has become China's first overseas market for sovereign debt, and the move has been seen as confirmation of the Chinese government's efforts to liberalise its fiscal policy and popularise its currency around the world. Investors bought ¥5bn in one-year bills in a transaction that was oversubscribed six times. It is anticipated that China will be prepared to issue longer-term renminbi bonds as a result. The debut sale was timed to coincide with the first day of president Xi Jinping's state visit to the UK last month.

Fintech companies grow in number and stature

> Financial services is just the latest in a long line of industry sectors to find itself under assault from new entrants with disruptive, technology-heavy alternatives to cumbersome existing business practices.

Financial technology (fintech) companies now number in the thousands, with more than a dozen estimated to be worth more than \$1bn – so-called ‘unicorns’ in the language of Silicon Valley start-ups.

The ethos they share is to reboot the electronics payment system to make it easier, faster, more convenient, efficient and accessible, no matter which device a customer is using. This approach has already

Fintech companies now number in the thousands

revolutionised the retail payments market and fintech firms now have other sectors in their sights, including FX, wholesale and corporate payments.

For established banks the impending assault represents a serious challenge to their business models. Many are underprepared when it comes to coping with the changes. According to a study from BNY Mellon, *Innovation in Payments: the Future is Fintech*, this is mainly down to the fact



that institutions have been hampered by the wealth of new regulations imposed in the wake of the global financial crisis. This has left them short of cash for research and innovation, which has opened up the opportunity for start-ups.

A recent report from professional services firm Accenture revealed that 72% of senior industry executives believed their bank had only a fragmented or an opportunistic strategy in place for digital innovation.

And yet the rapid pace of innovation means banks must act faster to develop new technologies and replace legacy payments systems.

CHINA'S OUTLOOK IS STILL MIXED

> Suspicions about the veracity of China's economic data were heightened after the country's central bank surprised markets by cutting its benchmark interest rate by a quarter point to 4.35% – its sixth cut since last November.

The move came as China's MNI business sentiment index hit its second-highest level this year in an indication of improving business prospects.

The mixed bag of data was reflected by capital outflows from the People's Republic, which showed some \$500bn was withdrawn during the first eight months to 2015.

While the shift reflects the changing fortunes of the global economy this year, investors are also concerned that slowing economic growth in China could be worse than feared – or at least what is admitted publicly.

During the third quarter the economy grew faster than expected, thanks to the emerging services sector, which helped offset weakness in the manufacturing and property sectors.

GDP was up 6.9% in the three-month period, down from 7% in the first two quarters, but leaving China roughly on course to meet its full-year target of around 7%.

Of most concern to investors is the continued slowdown in growth for Chinese factories, which has led to a knock-on effect for global energy and commodities prices.



ECB likely to expand QE

The European Central Bank (ECB) bolstered equity markets by indicating it would expand its €1.1 trillion quantitative easing (QE) programme in December and cut its deposit rate should the slowdown in emerging markets threaten the euro area's recovery.

The ECB has bought €60bn of debt, mostly government bonds,

every month since March and plans to continue doing so until at least September 2016.

Mario Draghi, ECB president, has admitted that the threat from slowing emerging-market growth – particularly in China – poses the biggest risk to the eurozone.

The ECB will next meet in early December – ahead of the hotly anticipated meeting of the US rate-setting Federal Open Market Committee, which could move to increase the cost of borrowing.

Morgan Stanley profits

Wall Street giant Morgan Stanley disappointed investors with a fall in

quarterly profits that came in well below market expectations.

The group's earnings slipped for the second consecutive quarter, with revenue from trading activities down 17.2% to \$2.03bn. To blame was largely the volatility of global stock markets, which particularly dented Morgan Stanley's fixed-income business and its merchant banking operations in Asia.

The bank's increasingly important wealth-management division also suffered, with revenues falling 3.5% to \$3.64bn. This accounted for 46.9% of group revenues

compared with 42.4% in the same three months a year earlier.

Morgan Stanley has been battling to beef up its wealth-management unit to reduce its reliance on more volatile business lines in the wake of the financial crisis. It has also been forced to reduce trading on its own book due to stricter regulations.

This has meant investment banking revenues have continued to decline, falling 15.3% to \$1.31bn, while Morgan Stanley retained its strong position advising on M&As.

OECD BEPS finalised

The Organisation for Economic Co-operation

and Development (OECD) has released its final set of proposed international tax reforms. Known as Base Erosion and Profit Shifting (BEPS), the work has sought to identify tax-planning strategies that exploit gaps and mismatches in tax law and that enable companies to artificially shift profits to low or no-tax locations where they have little economic activity, thus lowering their corporate tax bills. The OECD has described its package of 15 final reports as involving the 'most fundamental changes to international tax rules in almost a century'.



EMIR, CVA, BEPS AND FTT

Leader of the opposition Jeremy Corbyn has started to liven up UK debate, with nationalisation and fiscal expansion firmly returned to the political agenda. Meanwhile, Tsipras returned as prime minister in Greece to implement unwanted austerity measures. The transmigration refugees have forced the EU member states to recognise the risk of treaty dogmatism. Our attention remains with EMIR and CVA, BEPS, renminbi and FTT. Please share any views with us at technical@treasurers.org



Steve Baseby is ACT associate policy and technical director @BasebyStephen

{ IN DEPTH }

EMIR AND CVA

We will join our fellow EU associations to work via the European Association of Corporate Treasurers (EACT) to respond to the European Securities and Markets Authority's (ESMA's) own response to the European Market Infrastructure Regulation (EMIR) consultation. ESMA dismissed single-sided reporting (SSR) and sought a review of the hedging exemption and collateralisation thresholds. ESMA had undertaken a review of the data at treasury repositories (TRs) as at February 2015 (<http://tinyurl.com/qykykne>). Some remarkable facts emerged: seemingly illegal non-financial counterparties (NFCs) to NFC forex transactions; and firms

reporting both as a financial counterparty (FC) and an NFC for different transactions, which is perhaps more symptomatic of the risk of relying on an FC to report on one's behalf. ESMA drew the conclusion that dual-sided reporting remained important and did not add to confusion, as a plethora of entities began what for them was novel reporting through dissimilar TRs.

More vital is that the ESMA analysis of data not available to parties other than ESMA and member states. National Competent Authorities, such as the Financial Conduct Authority for the UK, showed that NFC trades by nominal value remain at only 2% of the overall market, although 100,000+ NFCs are now obliged to report against 28,000 FCs supporting both our call for SSR, and our belief that no NFCs could be systemically risky.

ESMA has suggested only exempting SMEs from the reporting obligation. While this may relieve a material number of corporates from reporting, a partial exemption would appear to only confuse the overall data as a systemic data asymmetry is adopted.

Also of note is that ESMA continues to fail to understand that derivatives are used by most NFC

cost weighting on banks for transactions with NFCs, which do not have to collateralise under EMIR. CVA contradicts the spirit of the EMIR hedging exemption and will emerge as an increased margin on derivative pricing. It is difficult to see a challenge succeeding to its implementation.

Resolving the requirements to report trades and for some to collateralise becomes

ESMA has suggested only exempting SMEs from the reporting obligation

businesses 100% for hedging, with no speculative positions.

In parallel, a review of reporting field specifications for EMIR trade reporting is being undertaken by the Bank for International Settlements (BIS) in an effort to conform the reporting made meant TRs, in an effort to improve data quality and enable quicker pairing. We are responding to this BIS initiative to remind it that too much change can be resource-expensive, and that this is one area where top-down explicit direction would be of value.

Meanwhile, the European Banking Authority continues to implement Credit Valuation Adjustment (CVA) – a capital

increasingly important, as the earliest date for collateralisation could be 2017, and the EMIR legislation is expected to be reviewed only tri-annually. Also, change as suggested in the current round of consultation would require Level 1 revision of legislation, that is changes made in parliament to the legislation, and this is a protracted process for which the outcome can be uncertain, as lobbyists endeavour to influence the politicians.

The ACT has circulated a copy of the position paper (see www.treasurers.org/eact-on-esma-oct2015), which the EACT will present to ESMA and the EU Commission on behalf of EU corporates. We ask for you to feed back at technical@treasurers.org



The central bank continues to actively support renminbi through market intervention drawing on China's immense FX reserves



{ INTERNATIONAL }

BEPS

> The Organisation for Economic Co-operation and Development has issued its final recommendations (www.oecd.org/ctp/beps.htm) for Base Erosion and Profit Shifting (BEPS).

Consensus has emerged among 60+ countries on the means to avoid multinational enterprises earning revenue in one regime, but reporting the profit in another for tax advantage. This is clearly a noble exercise, and one now gaining popularity in major as well as developing economies as it emerges that many corporates avoid tax in G20 member states.

Multinational corporates will need to monitor BEPS implementation, which will at the least impose reporting obligations. See the Thomson Reuters round-up at <https://tax.thomsonreuters.com/BEPS>



View technical updates and policy submissions at www.treasurers.org/technical. Elsewhere on the web:

Concern over waning use of covenants in debt markets: see <http://tinyurl.com/pyylbug> for an article on the state of debt covenants as lenders seek yield.

The clever people at the Organisation for Economic Co-operation and Development have been thinking about how Capital Markets Union could be implemented through the use of an improved securitisation market, but using bank receivables financing. See <http://tinyurl.com/nquh98o>

{ RENMINBI }

Freer movement of cash cross border, but tighter forex controls

> China is both extending the liberalisation of renminbi cross-border transactions, while trying to dampen currency speculation. The People's Bank of China (PBoC) has loosened the parameters for cross-border pooling of renminbi to ease the rules on flows in and out of China. The new rules raise the cap on net inflow for renminbi funds from 10% to 50% of shareholder equity in the cash pool. Both non-Chinese-headquartered and Chinese-headquartered multinationals will benefit. There is no cap on outflow of funds under the scheme. Six banks have won pooling mandates from 13 multinationals and although in force since 23 September, PBoC estimates about ¥13.3bn of capital inflow has been drawn onshore.

Meanwhile, the central bank has informed banks that it will impose a 30% reserve requirement on forex forwards to discourage speculation on the renminbi and continues to actively support renminbi through market intervention drawing on China's immense FX reserves.

{ TECHNICAL ROUND-UP }

MiFID 2 AND EMIR

MiFID 2 moves closer to implementation with a due date of 3 January 2017. Two problems have been identified for corporates.

Electronic dealing systems, such as 360T, have entered common use. These are classed as organised trading facilities and multilateral trading facilities. Non-financial corporates trading on their own account have been able to rely on an exemption under MiFID. This exemption has ensured corporates are not subject to MiFID obligations when using these systems, nor subject to CRD IV. The draft MiFID 2 legislation (known as Level 1 and subject to agreement in the European Parliament) no longer makes this exemption clear. The EACT and ACT have been making representations to seek extension of the exemption, but this does require amendment to the draft legislation and this cannot be certain until passed.

MiFID 2 will impose restrictions on the ability of EU corporates, which seeks to catch speculative trading, by enabling an exemption of trading activities which are 'ancillary'. There is concern over the lack of definition of this term. The risk is exposure to authorisation under MiFID, and if that is not required, an annual notification of exemption.

While there is a consultation process under way for the EU EMIR, Hong Kong and Singapore authorities are developing their regulatory regime for OTC derivatives. (<http://tinyurl.com/qf7bau6>).

Similarly to EMIR, there is mandatory reporting and a clearing threshold. A difference is that deliverable forex forwards are excluded from reporting and clearing, or calculating the clearing threshold.

{ WATCH THIS SPACE }

FINANCIAL TRANSACTION TAX

Financial transaction tax (FTT) has re-emerged, with some 11 EU member states pushing for agreement early. Although the economic impact arguments remain, some states are calling for hypothecation of the tax to fund climate change investment. The latest view is that it will be

a low tax on equity transactions and derivatives (taxed on a resident's basis).

There is already some suggestion of exemptions for the 'real economy', such as small cap firms, and possibly a hedging exemption, but uncertainty remains as to how

such transactions could be economically separated.

Corporates not domiciled within the member states (such as the UK) should not be complacent about the impact of FTT. They must consider the domicile of their counterparty and the potential cost impact on that counterparty.

60-SECOND INTERVIEW



ELISABETH HERMANS

ANALYST TREASURY –
JOHNSON & JOHNSON, PARIS

How did you get into treasury?

My interest in treasury started when I was working for PwC as a transfer pricing consultant, when I got the opportunity to work with various corporate treasurers.

What do you like about treasury?

Working on challenging projects and the potential for continuous improvement. The world of treasury is ever-changing, you just never stop learning.

What's the best thing about being a treasurer?

You can make an impact and bring added value to the company.

What's the best thing about being a member of the ACT?

The networking and the sharing of best practices.

What's the most unusual responsibility that you have as a treasurer?

An unusual moment was when the credit markets began to change and negative returns were earned on some currencies. How to explain to the affiliates that we needed to pay to invest their funds!

What's the most important lesson that you've learned during your career?

You can change your reality. There can be a moment when you feel stuck in the middle, but you're not stuck because you're in the middle; you're stuck because you're waiting for someone else to act. Don't wait – take control yourself.

What would be your best piece of advice to someone else considering a career in treasury?

Join the treasury organisation of a large international group where you will get the opportunity to work in various areas of treasury.

What's your ultimate career goal?

To have worked in various regions of the world, while becoming a subject matter expert in treasury.

Who is your greatest inspiration and why?

Richard Branson because he is a true people leader, somebody who passionately believes in what he is doing and who wants to make a positive difference.

If you weren't a corporate treasurer, what would you be and why?

Travel photographer – to get paid to travel and capture the world's most beautiful places.

✦ 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

ACT TRAINING

16-20 November, London

The A-Z of corporate treasury

A highly interactive course providing a comprehensive overview of treasury operations, this is the perfect forum for new entrants to the profession, bankers and those working alongside the treasury function. 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.

15 March 2016, London

Treasury in a day

Gain an insight into the activities of a corporate treasury department and how treasury can support business strategy – particularly when facing challenges such as market instability and international competition.

22 March 2016, London

Working capital optimisation

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✦ To view more courses or to book online, visit www.treasurers.org/training. For more information, contact Radmila Trkulja at rtrkulja@treasurers.org or tel +44 (0)20 7847 25733

ACT EVENTS

11 November, London

ACT Annual Dinner

Taking place in the sumptuous surroundings of the Great Room at the Grosvenor House Hotel, the Annual Dinner is an opportunity to network

with your peers, while enjoying a three-course meal and fine wine in one of the most prestigious venues in London. Last few tables remaining! www.treasurers.org/annualdinner

23-24 November, Dubai

ACT Middle East Annual Conference 2015

Strategy, agility, prosperity

Bringing together more than 400 industry professionals each year, the ACT Middle East Annual Conference is the pre-eminent corporate treasury conference and networking event for the Gulf Cooperation Council region. www.treasurers.org/actmiddleeast/annualconference

10-11 February 2016, London

ACT Cash Management Conference

Join Europe's largest conference devoted purely to cash management, featuring world-class case studies from leading corporates. Benefit from increased participation in sessions and get your questions answered. www.treasurers.org/cashmanagement

9 March 2016, Düsseldorf, Germany

ACT Europe Conference 2016

The ACT Europe Conference returns to Düsseldorf in 2016. Organised in partnership with the Verband Deutscher Treasurer, it is the ideal occasion for treasury and finance professionals from across Europe to discuss their key challenges.

18-20 May 2016, ACC Liverpool, UK

ACT Annual Conference 2016
Designed for treasurers, by treasurers, our annual conference addresses the challenges facing the real economy over three inspiring days. We bring together more than 1,000 treasury professionals from every major industry and from all levels of their career to network, benchmark and share best practice to further the development of the profession. This year's theme is Financing tomorrow – integrity, influence, innovation. www.treasurers.org/annualconference

✦ To attend an ACT event, book online at www.treasurers.org/ events. For more information, email events@treasurers.org or call +44 (0)20 7847 2589

ACT WEBINARS

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{ EMERGING MARKETS }

JEREMY WARNER

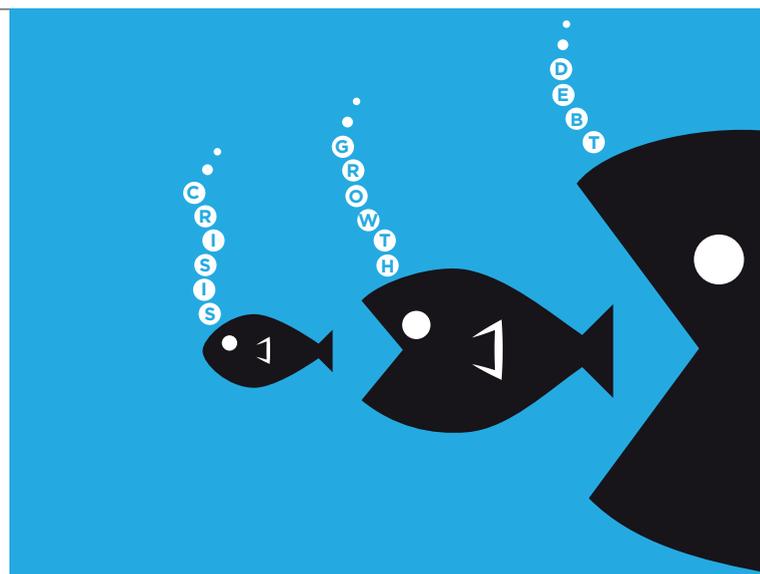
Developing economies are long on debt and getting short on liquidity. And it's not clear what impact that might have on Western economies should it reach a crisis point

Virtually all serious financial crises are preceded by a rapid build-up in credit and leverage. In advanced economies, we've had lots of recent experience of the economic destruction that excessive leverage is capable of inflicting.

Yet the lessons seem to have been almost entirely forgotten in emerging markets, where, according to analysis by the International Monetary Fund (IMF), non-financial corporate debt has quadrupled to more than \$18 trillion over the past 10 years, far outstripping economic growth as a whole. The economic slowdown in China has raised fundamental questions about the quality of the assets that underlie this extraordinary level of credit expansion.

Let's be clear. There is as yet no fully fledged emerging markets crisis. Yet there is already a problem with liquidity. The Institute of International Finance predicts that net capital flows to emerging markets this year will be negative for the first time since 1988. When liquidity dries up, it has a nasty habit of quickly transmogrifying into a wider problem with solvency.

How did we get to where we are, and what sort of a threat would another serious emerging markets crisis pose to Western economies?



The irony is that the growth in emerging market debt is primarily a consequence of unprecedented monetary expansion in advanced economies. This might have succeeded in easing the plight of Western debtors and thereby preventing mass default in the wake of the 2008/9 banking crisis, but it has also had the unintended consequence of inflating new bubbles elsewhere.

This has not been through the normal channel of conventional cross-border lending. Rather, Western bankers have, on the whole, reduced their overseas lending in an attempt to rebuild balance sheets impaired by the financial crisis.

The IMF highlights three alternative transmission

mechanisms. One is that low Western interest rates have forced emerging market central banks to reduce their own rates so as to alleviate currency appreciation and maintain competitiveness. By the same token, central bank money printing in Western markets has prompted a 'search for yield', driving down rates in emerging markets through portfolio flows. Risk aversion may remain strong in advanced economies, but the same has not applied to once fast-growing developing economies.

And finally, bond markets have stepped into the gap left by bankers, providing an easy source of finance to many emerging market companies.

Firms that are highly leveraged are plainly going to be vulnerable to any reversal in these post-crisis levels of monetary accommodation. Shocks in the corporate sector could easily spill over

to the financial markets and the real economy as banks curtail lending to deal with a growing bad-debt problem.

More worrying still, the IMF analysis shows that the debt build-up is heavily weighted to cyclical sectors, such as property and construction, and carries a high degree of foreign currency exposure. Any depreciation in the local currency will therefore cause the effective debt burden to rise, further increasing concerns over banking and, therefore, national solvency.

The last serious emerging markets crisis in the late 1990s didn't affect Western economies very much. However, financial markets have become much more interconnected since then, and emerging markets are a much bigger part of the global economy. Until it happens, there is no way of telling what the effect on financial markets and business confidence more generally might be. No wonder the Fed is holding fire on interest-rate rises. The global economy remains incredibly fragile. The last thing it needs is an emerging markets crisis to take over where the Western one left off. ♡

SHUTTERSTOCK



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

There is as yet no fully fledged emerging markets crisis

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Don't put off until tomorrow...

Wavering at the US central bank has made decisions around increasing interest rates all the harder and has made the US economy look weaker than it actually is, says Kallum Pickering

After a long run up, the Fed decided not to jump at its September meeting. The dovish tone of the minutes revealed its concerns about risks abroad, namely those in China and emerging markets, in addition to the continued dampening effect of low commodity prices on US inflation. Markets interpreted the decision as a sign that the Fed is worrying about the economic health of the US, rather than just an act of caution amid heightened risk, and this has raised doubts as to whether the Fed will increase rates before the end of 2015 at all. And now the market, much like the Fed, seems a bit confused about what's going to happen next.

This is not an ideal place to be. How did we get here? Though markets have played their part, the blame lies with the Fed. A series of conflicting comments about a possible first-rate hike, frequent changing of goalposts through its forward guidance policy and over-sensitivity to highly volatile short-term data has left the Fed looking dangerously disoriented. The uncertainty it has created is not just damaging to the US; the expectation that it would increase rates soon has exacerbated the pace of capital flight away from emerging markets already faltering on low commodity prices. Driven by increased demand for US assets, the dollar has surged. The Bloomberg dollar index has increased by 20% since June 2014. For emerging markets – particularly those that had accumulated dollar-denominated debt – the damage was already done before the September meeting.

US policymakers steer the largest economy in the world. They are and ought to be concerned about the impact of US domestic policy on foreign affairs.



IKON IMAGES

Paradoxically, on this occasion, by trying to avoid negative consequences globally, they have created a new uncertainty. Until the Fed held back from hiking rates in September, the view was that the US economy was on the path to normality, a bright spot against a wavering global backdrop. By delaying, the Fed has brought that analysis into question. And yet the US economy is in reasonable health and the Fed ought to have increased rates by now.

The goldilocks conditions the Fed seems to be waiting for before it hikes aren't likely any time soon. Indeed, the current global mix is not so abnormal in the context of a longer history. Commodity prices aren't inconsistent with long-term historical prices, emerging markets are back to being a mixed and somewhat volatile bag, and the developed world is looking stable

again. The Fed must then focus on the US economy, which is ticking along nicely, though at a slightly lower trend rate of growth than in the past. Looking at the key components: GDP growth is likely to run at a satisfactory rate of around 2.5% for the next few years, the labour market looks close to full employment and continues to improve, and retail and housing are consistent with robust domestic demand. We do not see how a 25bps rise rate poses a risk to the US economy providing the Fed is clear that the path of rises thereafter will be gradual.

The Fed's paralysis will limit other central banks, too. It is unlikely that even the Bank of England – also expected to hike soon – will move before the Fed. Despite its failings and somewhat eroded credibility, the Fed still leads the way from both a policy perspective and in its view of the world. Proving to the global economy that the US can handle a rate hike would be ideologically profound. It would quash fears that the developed world is heading for 'Japanification'. Such reassurance would be a strong stabilising factor for the global economy, not a destabilising one. The question is, having tried and failed on a number of occasions, twice so far in 2015, just how does the Fed get over its fear and finally raise rates? ♥



Kallum Pickering
is senior UK
economist at
Berenberg Bank



THIS IS **NOT** A DRILL

Cybercrimes may once have been on the periphery of corporates' risk management frameworks. Now they are viewed more as a racing certainty. Christian Doherty takes a look at mounting evidence that cybersecurity needs to be central to treasurers' thinking

One of the difficulties around trying to home in on cybercrime and the techniques used to con companies, banks and individuals out of money is the fact that whatever is eventually uncovered will instantly be out of date.

Just as the furore over the Ashley Madison hack that saw the personal details of 32 million users of the Canadian dating site leaked into the public domain in a blackmail scam had died down, came growing evidence that the cybercrime threat is growing and becoming something of a constant.

In October this year, the UK's National Crime Agency announced it was investigating the theft of more than £20m from bank accounts by hackers using malware known as Dridex. That came on a day when even a cursory glance at any newspaper website brought more evidence of cause for concern: Russian hackers design USB stick that can 'fry contents of any laptop'; well-known YouTubers, including W2S and NepentheZ, targeted by criminals who gained access to their EA accounts to steal thousands of pounds worth of in-game currency; TalkTalk's huge loss of customer data last month only adds to the growing list of successful cyberattacks. The list goes on.

The growing tide of cybercrime

These are not isolated incidents. Some of the most salient points from recent UK government cybersecurity research, carried out by audit firm PwC, show how widespread cybercrime now is. In the past year, 90% of large businesses and 74% of smaller firms have experienced some kind of breach.

The survey also revealed that there were up to 5.1 million incidents of online fraud involving 3.8 million victims in the 12 months to September 2015. Just over

half involved some initial financial loss to the victims and more than 62% were compensated in full.

Amid this growing tide of cybercrime, the need to protect assets is especially pressing for treasurers, given that they are on the front line of operations at the nexus of banking and payments. But the changing nature of cybercrime is muddying the waters of just who in the business is responsible for designing the right anti-fraud framework.

"The treasurer has to be worried about the security of the company's assets – whether cash or similar – and their vulnerability to external threat," says Peter Matza, engagement director at the ACT.

"But the treasurer must be realistic and recognise that, while he can influence some aspects of corporate life, he may not be able to influence them all. For example, 'what are my payment processes' needs care; 'what does the company sell on its website' can't be a treasury responsibility," he says.

The mounting sophistication of hackers' systems

Given the increased dependence of many companies on technology, it isn't surprising that the efforts of cybercriminals have become increasingly sophisticated. Certainly, the world has moved on from hackers simply targeting bank accounts or credit card details. Some of the recent, high-profile cases have illustrated the changing nature of cyberattacks.

Theft of cash via hacked bank accounts is giving way to a bigger, longer game. Chris van Dijl has worked as a corporate treasurer and now runs consultant company Cugavadi, which helps businesses improve their security measures. He has seen the shift from theft to extortion attempts.

"We've seen examples of where you had cybercriminals saying to their victims: 'We've broken your security. We've got something of value to you,'" he explains. "And 'We'll put a service attack on so you can't operate as a business on the website that's really important to you. Once they've done that, they will start to try and have a discussion with you that involves ransom and extortion.'" This happened in the Ashley Madison case, where no funds were stolen, simply user data, which was then used as a weapon for extorting cash from the site's owners.

Van Dijl spends a lot of his time working with clients on assessing the threats they face and designing frameworks to combat them. This usually focuses on good housekeeping rules: "We try to look at things like the use of authorised counterparties, for instance, so that each counterparty will have to comply with set parameters as per a counterparty risk policy document," he says. "The use of a different counterparty could actually be a breach of a covenant in loan documentation."

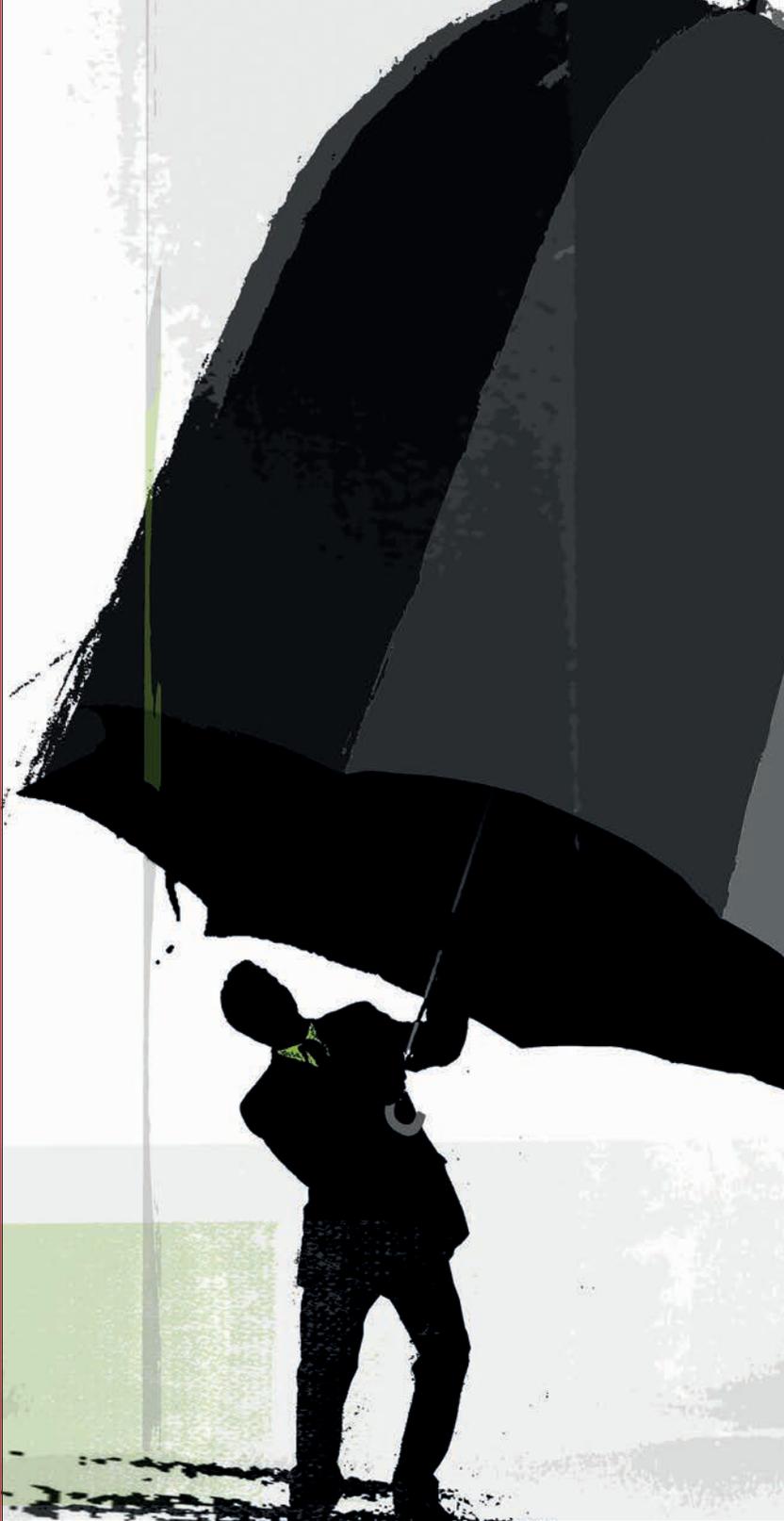
Beyond that, Van Dijl's best practice wish list for clients to protect treasury from cybercriminals includes: implementing approved strategies for managing payments; error prevention through constant updating and improvement; robust treasury audit; and the segregation of duties – under which dealing, recording, confirmation and settlement are all split to prevent internal fraud and potential compromise from external sources.

Treasurers should not forget that theft of data can now be as damaging as theft of cash. Credit card details are obviously extremely valuable, but any customer data falling into the wrong hands can cause huge reputational damage; would you do business with a company that failed to protect your details?

Beyond the enormous potential for blackmail and extortion, the possible repercussions from regulators are also considerable – the European Commission rules on data breaches will change next year. Currently, businesses are liable for a fine of up to £500,000 for

Amid this growing tide of cybercrime, the need to protect assets is especially pressing for treasurers, given that they are on the front line of operations at the nexus of banking and payments

5 SIMPLE STEPS TOWARDS TIGHTENING UP YOUR DEFENCES



1 Use secure memory sticks
The USB has become a ubiquitous part of office life and is a convenient way of transporting data. They are also exceptionally good at carrying malware and viruses designed to disable systems and generally wreak havoc. To counter this, a new generation of protected USBs is becoming available. USB sticks with built-in keypads can help to block unauthorised use.

2 Consider using a VPN
Virtual private networks (VPNs) can offer a vital tool in protecting businesses that need to communicate between different hubs over the open internet. By using a VPN, the business can create what amounts to a safe channel between two points (say, head office and a branch in the network), protecting data that passes through it, safe from any prying eyes (or malicious ones). The fact that a VPN is relatively easy to install adds to its attraction.

3 Always use double-factor authentication
Double or two-step authentication is a common-sense, no-frills effective way of ensuring unauthorised individuals don't gain access to devices or systems containing sensitive information. It requires authorised managers to use two different methods of identification to access sensitive applications – a password and digital signature, for example. There is a growing range of authentication tools in the market – Apple, for instance, is pushing its biometrics solution Touch ID, which uses thumbprint technology to block unauthorised access to mobiles and tablets.

4 Consider testing your defences
Engaging the services of a security consultant to test the strength of your cyber defences can be a useful way of exposing vulnerabilities quickly and quietly. The growth of 'ethical hacking' services in recent years has mirrored the rise in cybercrime. This is a valuable exercise – several large banks have submitted themselves to so-called cyber war game exercises recently, and the Bank of England has made no secret of its exercises and efforts in this area.

5 Look into government schemes
The HMG Cyber Essentials Scheme sponsored by the UK government sets out to help smaller businesses understand the threats they face and the steps they can take to protect themselves. Described as basic cyber hygiene, the scheme has developed into an assurance framework for businesses in need of greater protection. See: www.gov.uk/government/uploads/system/uploads/attachment_data/file/317480/Cyber_Essentials_Summary.pdf

a data breach. However, under the new rules, that could change to anything from 2% to 4% of global revenue.

Alongside data breaches sits the rise in so-called spear phishing. A recent incidence of this was particularly worrying, given the simplicity of the attack: US firm Ubiquiti Networks reported that it had been the victim of a scam that saw \$46m pilfered from its bank accounts by cyber thieves. The attack was devastatingly simple: fraudsters managed to get the company to wire transfer funds based on a forged email that looked like it came from a senior executive.

This type of scam is different to the volume-driven phishing attacks of the past, where the criminals play the odds. Sending 100,000 emails may turn up a catch; spear phishing, as the name suggests, is based on a patient, targeted and specific approach. Criminals stalk their prey by researching the company, gathering as much information as possible. They find the names of executives, they look into supplier relationships and follow staff on social media.

How to protect your organisation against a cyberattack

The intention is to build a picture of the company in order to design a plausible fraud: thieves may send a mail purportedly from the sales director to the FD asking for authorisation on a payment to a supplier, or a request to click on a link that will lead to a virus or other malware. A less-than-vigilant response – say, a single verification of payment, or lack of awareness of clicking on unsolicited links – can spell disaster.

For Bob Stark, vice president of strategy at treasury security systems vendor Kyriba, combatting these types of attack demands a lot from treasury teams. “What I find treasury has in common with the rest of the organisation is really two things: data security and application security,” he says. The first? “That covers making sure that the actual data is encrypted and stored in a safe place. Some IT departments will recommend that data is pushed into the Cloud, or at least off-premise in some way, because they

recognise that having it in an internal server room is an unnecessary risk and compromises data security.”

The second consideration, according to Stark, is application security, which involves designing adequate controls within the technology tools that they use. “In treasury, that’s often [within the] bank and it’s going to be treasury management systems; in some cases, it might be trading portals as well.”

These technologies need to abide by basic security protocols, such as strong password controls, two-factor authentication, IP filtering and so on.

“With the right technological tools, treasury is able to monitor bank accounts and potentially identify any abnormal transactions to be followed up promptly, which does potentially increase the chance of recovery of funds”

For Rachael Fisher, group treasurer at manufacturing business Rotork, the twin approach of tackling data and application security is a big part of her anti-fraud strategy. So where does Fisher see her role in protecting the company from the worst of the cybercriminals?

“Since an increasing proportion of cybercrime relates to attempts to obtain cash, our role is central to the fight against cybercrime, working in partnership with other departments – IT for instance,” she says, pointing out that treasury is perfectly placed to work with banks to understand the controls they have in place and to obtain best practice recommendations around internal processes.

“Treasury is the team that works with banks if crime attempts happen, to seek to recover the financial losses or provide

evidence to support insurance claims,” she says. “And, of course, we are often deemed to be responsible for ensuring group procedures are robust enough to prevent fraudulent payments and for communicating with those involved in payment processes to ensure they are aware of current trends in cybercrime and appropriate responses.”

Risk management policies and technology

But Fisher points out that treasury teams have to grasp the nettle on this issue and not leave it to the IT function. “With the right technological tools, treasury is able to monitor bank accounts and potentially identify any abnormal transactions to be followed up promptly,” she says. “And while you could see this as shutting the stable door after the horse has bolted, prompt follow-up of these does potentially increase the chance of recovery of funds and it could also be regarded as a deterrent for crime being initiated from within.”

Stark agrees, but points out that no matter how sophisticated the system may be, the policies that underpin its operation are more important. “Treasurers have to review their policies to ensure that they align with everything from general internal policy to being cognisant of the risks that are out there today; they need to ensure their policy is modern and aligned with what the risk profile is.

“Any risk management approach has to be a combination of reviewing what you have in place: does it meet your objectives? Is it protecting you from the risks you face?” he says. “If the answer is yes, great; you’re in good shape. Review of those is absolutely crucial.”

No system can replace sensible policy adopted across the organisation, Stark points out. “Technology should be put in place to actually implement and support that policy,” he says. “So if you’ve great policies, but you’ve dire technology, you’re going to be exposed. If you’ve great technology, but it’s not implemented around great policies, then, once again, you have the same problems.” ♥

Christian Doherty is a business journalist

Criminal exposure

Managing and responding to corporate crime risk is no easy task, but a legal and ethical responsibility nonetheless. Christopher David sets out the obligations for treasurers and the parameters for internal investigations

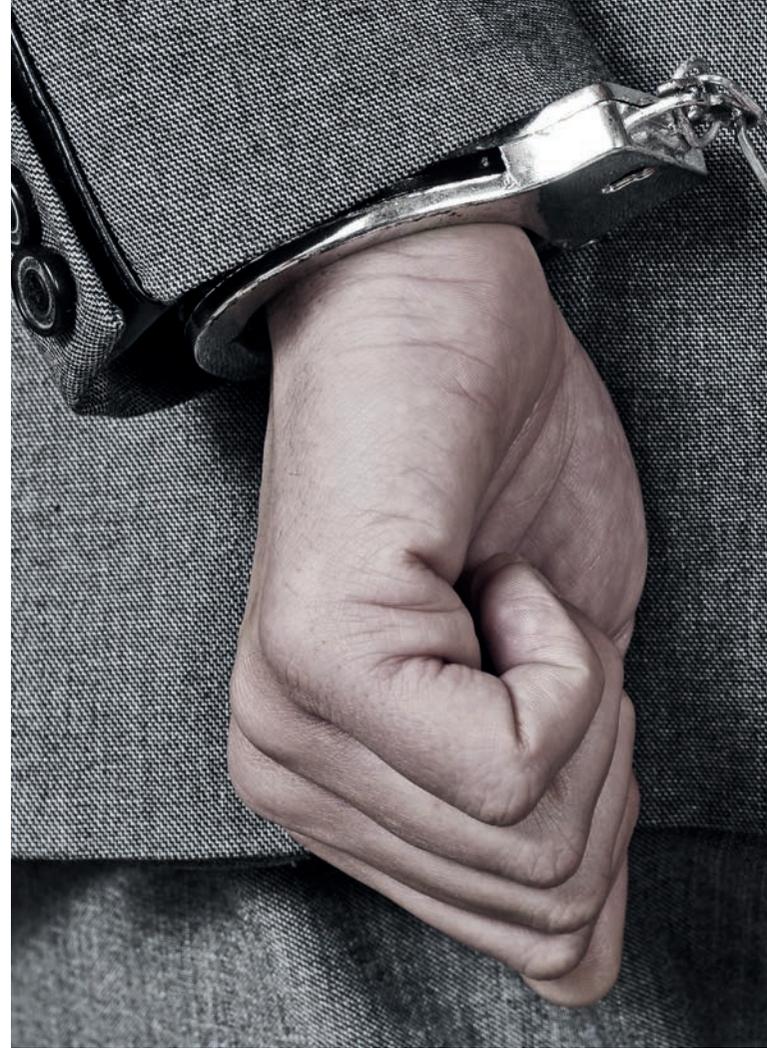
Corporate crime is a current hot topic: financial services, sport, defence, mining, engineering and the pharmaceutical sectors have all been the subject of high-profile and very public investigations, which, in some cases, have resulted in multimillion-pound fines. In a number of these cases, the conduct could potentially have been identified and stopped by a company's treasury function. This is not to say it is easy to identify and stop conduct of this nature – businesses are complicated and it is impossible to second-guess decisions by senior executives or rogue employees, but being alert to potential red flags in relation to fraud and corruption can go some way to protecting a company. Additionally, if illegal or suspected illegal conduct is discovered, then it is vital that a company takes considered and appropriate steps to investigate it.

Fraud and corruption convictions carry significant fines for the companies – and prison sentences for the relevant individuals – and would be a breach of the ACT's Ethical Code.

Looking for warning signs

Each business will require its own clear and, preferably, concise set of systems and controls that suits its particular industry and structure, but, from a treasury point of view, two key areas to focus on are M&As and capital expenditure. On a relatively simplistic level, these areas are where there are significant outflows of company funds and therefore carry the risk of misuse or misappropriation, but also are occasions where a treasurer may have an opportunity to spot potential red flags.

Obviously, a large part of this responsibility falls to the legal and/or compliance function, but it is worth being aware of the more common potential red flags. On a simple level, extra care should be taken if the transaction or the third party is in a country known for widespread corruption, as measured by the Transparency International Corruption Perceptions Index. Reputational checks should be carried out on all third parties and any suggestion of a poor business reputation should be investigated thoroughly. Any link that a third party,



to whom a payment is being made, has with a government official should be treated with extreme caution. This includes taking steps to identify beneficial owners of shell companies. Finally, care should be taken if any party, internal or external, requests approval of a significantly excessive budget or unusual expenditures.

From a treasury point of view, extra care should be taken in relation to payment instructions that fall just below delegated approval limits or are brought within this limit shortly before completion of a transaction. Unusually large requests for funds for capital expenditure from overseas subsidiaries should also be carefully reviewed and considered before any funds are made available.

Unfortunately, no matter how robust a company's systems and controls are,

it is almost inevitable that, at some point, something will go wrong. Once a possible issue has been discovered, it is vital that a company moves quickly to investigate the allegations. It is a common response to want to establish as quickly as possible what has happened, but it is almost always advisable, however, to take a step back and consider carefully the scope of any investigation before beginning the substantive work. This is critical both in relation to deciding the ultimate objectives of the investigation and, in practical terms, how these objectives are going to be achieved.

Taking action

An internal investigation can be complex and long, and it is not possible, for reasons of space, to set out in detail everything that a company should do. However, the first thing a company should do

The **ACT** Ethical Code can be found at: www.treasurers.org/ACTmedia/ethical_code1.pdf

Whoever is conducting the investigation, whether they are internal or external to the company, should establish the investigation's precise scope carefully and clearly at an early stage. An internal investigation is not intended to be a fishing expedition to identify any and all potential problems a company may have, but rather a response to a particular and specific problem that has been identified. This is not to say that unanticipated issues coming to light in the course of the investigation should be ignored, but rather that a precise and focused investigation will undoubtedly be more effective at resolving issues in a time- and cost-effective way.

Securing the evidence

Once an investigation plan has been agreed, it is important that a company takes immediate steps to secure all relevant evidence. This should include all relevant electronic data, hard-copy documents and electronic devices. Care should be taken that routine document destruction and electronic deletion programs are stopped. Additionally, all potentially relevant electronic

devices, such as laptops, phones and hard drives, should be secured. Relevant employees should

be informed by way of a document hold notice what material should be preserved without giving away details of what the investigation relates to. If necessary, a specialist forensic IT team should be brought in to ensure reliable evidential collection, as well as to assist with recovery of deleted data. Once the data has been secured, a careful review of the available evidence should be conducted so as to build up a set of facts that's as clear as possible.

A further issue that should be considered at the outset is the status of any employees that, on the face of it, may be implicated in the conduct under investigation. Normally, the most prudent approach will be to suspend any employees concerned with immediate effect, pending the outcome of the investigation. Once the internal investigation is complete, the decision will have to be made whether to dismiss the employee, reinstate them or extend the period of suspension.

Finally, care should be given as to how any findings are recorded. There is no requirement in English law to report a criminal offence, whether that be an employee or the company itself. A company's decision to self-report should only be done following advice from experienced external counsel, as a misstep at this stage could result in serious implications for the company for many years to come. ♡



Christopher David is counsel at WilmerHale



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on realising that there is an issue requiring an internal investigation is to establish internally who is going to be responsible for conducting and/or managing the investigation. This person or group should have sufficient

authority to issue instructions on behalf of the company, as well as obtain relevant documents and material. This is important for the efficient running of an investigation as well as for creating a legally privileged environment.

POTENTIAL FOR EXPOSURE

The most common corporate criminal offences that arise are fraud, money laundering and corruption.

- **FRAUD** is a broad term, which covers any act of deception intended for personal gain or to cause a loss to another party. Common examples include false accounting, insurance fraud, mortgage fraud, Ponzi schemes, procurement fraud and pyramid schemes.
- **MONEY LAUNDERING** is essentially the processing and handling of criminal property,

including money derived from criminal conduct, and disguising it so it looks like it has come from legitimate sources.

- **CORRUPTION** is an agreement to directly or indirectly give, offer or promise anything of value to influence someone so as to obtain or retain a business advantage. The UK Bribery Act prohibits the giving and receiving of bribes to both private individuals and public officials and, in addition, the law specifically criminalises a company that fails to prevent a person associated with it

bribing someone with the intention of benefiting the company. This means that a company can be liable for the conduct of any third party that acts on its behalf. Third parties include agents, distributors, consultants, resellers and vendors. There is, however, a complete defence, if the company can show it had in place 'adequate procedures'. This concept of 'adequate procedures', in addition to providing a legal defence under the Bribery Act, is also the tool by which a company can try and identify criminal conduct.

FRESH START

Thames Tideway Tunnel is an environmental initiative designed to clean up London's River Thames. Enabling this from behind the scenes is a treasury department that group treasurer Pedro Madeira is building up from scratch

Words: **Ben Poole**
Photography: **Louise Haywood-Schiefer**

“It is an exciting time at the moment,” enthuses Pedro Madeira, group treasurer of Thames Tideway Tunnel from the company’s canal-side offices in London. Madeira’s enthusiasm stems from the fact that, while the nascent infrastructure project is a big deal for the UK capital’s main river, the treasury department is being built from scratch. “It is a £4.2bn project and the biggest infrastructure task ever undertaken by the UK water industry and largest supported government project, but at the same time it is a new company, so it has very much of a start-up feel about it,” he says.

When his own career was starting up, Madeira worked at Shell, initially in a short-term accounting role when the company was centralising all of its European finance operations in Glasgow. Then, in 2002, he had his first experience of treasury working on a project to centralise Shell’s bank accounts and operations into the UK. “This project was enjoyable and made me want to work in treasury,” says Madeira. “I was so convinced that I wanted to go back into treasury immediately, I started the AMCT qualification at this time.”

While Madeira moved offices with Shell from Glasgow to London as a management accountant, he finished his AMCT

and moved into Shell’s treasury in 2006. “Even back then, the middle- and back-office side of things was so much better than accounting,” he says.

Career take-off

Madeira moved to Heathrow Airport in 2008. While Shell had been focused on liquidity and FX, he had a variety of responsibilities during his time at Heathrow. “Initially, as I had done forecasting at Shell, I was to put in place the medium-term treasury forecast, except it was completely different from Shell,” he explains. Heathrow was completely debt-focused as opposed to the cash and FX focus at Shell. While the operations side may have been reasonably simple compared with his previous employer, the financing and derivatives side was far more complex.

“Managing a large derivatives portfolio does add another dimension to the treasurer’s job,” says Madeira. “Counterparty risk management is unique in the sense that it has both a quantitative aspect to it, but also softer relationship implications.” At Heathrow he took a dynamic approach in managing and monitoring exposure, often assisting banks to move exposure, bringing new counterparties into



VITAL STATISTICS

£4.2bn

the anticipated cost of the Thames Tideway Tunnel project (2011 prices)

500

the number of people employed on the Thames Tideway Tunnel project at the end of 2014

9,000

the number of anticipated direct and indirect jobs created by the project at the peak of construction

25km

the length of the completed tunnel, from Acton in west London to Abbey Mills in the east

35-65 metres

the depth range of the Thames Tideway Tunnel

7.2 metres

the diameter of the tunnel, which is the width of an average UK single-carriageway road

48 hours

the time it would take to empty the Thames Tideway Tunnel when full

PEDRO'S CV

2015-present

Group treasurer, Thames Tideway Tunnel

2010-2015

Assistant/deputy treasurer, Heathrow

2008-2010

Treasury manager, Heathrow/BAA

2006-2008

Treasury analyst, Shell

2004-2006

Management accountant, Shell

2001-2004

Various roles, Shell

QUALIFICATIONS

AMCT (2005), CIMA (2006)

the relationship and working with existing counterparties to bring them into other products.

It is always important to bear in mind that derivatives are a risk management tool, rather than a speculation tool, and that they have their time and place. In Madeira's eyes, treasurers can fall into one of two extremes when it comes to derivatives: "Some treasurers love derivatives too much and use them too often and badly, while others will simply run a mile from them," he says. "Heathrow had quite a large derivatives portfolio and I think that was absolutely the correct approach based upon its risk strategy."

Madeira has four basic rules for hedging:

- Do not use derivatives if you can achieve the same result, and as economically, through natural hedging.
- Do think about the risk you are hedging and do not use something that is inappropriate or too long.
- Do not put any extra features in the derivatives on top of those you know you need. If you are planning on holding it to maturity, do not put breaks on it; make sure you have considered the cash-flow impacts of all the clauses.
- Always have an eye on counterparty risk.

Thames Tideway Tunnel

Connecting east and west London, the Thames Tideway Tunnel will link to the London sewer system and to water-treatment plants owned by Thames Water to clean up the River Thames. The tunnel will be delivered through the formation of a new regulated business – the 'Infrastructure Provider' – dedicated to the implementation of the project. Under the provisions of the Flood and Water Management Act 2010, it will have its own licence from Ofwat. The company will build, own, finance and maintain the project and will be regulated by Ofwat.

As a well-known project in the big infrastructure area, Madeira was well aware of it and, when the role of group treasurer came up, it was a natural position for him to go for. "A lot of my responsibilities are to do with the company," he says. "Everything is new and many of the people I meet have been working here for a year or less."

Madeira's key responsibilities have included putting the treasury team in place, establishing the appropriate systems, policies and processes, and ensuring all is in place for day one.

"One of the company's priorities is to change the relationship between London and the river"

Work at this point has been progressing in two stages, the first of which revolved around the company becoming fully independent from Thames Water on 24 August 2015. The second stage is focused on automation. Both stages were worked on in parallel, with the recognition that the fully automated straight-through processes would not be possible on day one. The medium-term objectives also look to the funding side and the risk strategy that is part of putting a stable funding platform in place.

"We do some external reporting, and will present results to investors, which is a fascinating thing about big private equity," says Madeira. Private equity companies have a limited number of shareholders, but can also have a lot of debt investors. This means that investor relations can become a treasury responsibility. Treasury may have to do town hall presentations and publish results, for example. "This is interesting as it is not usually something that treasury is as involved with – talking with the comms department, understanding what the message is that we are presenting, even writing part of the company's press releases," he says.

While the Thames Tideway Tunnel's strategic goal is obviously to deliver the project, the company has higher ambitions than that. "One of the company's priorities is to change the relationship between London and the river," says Madeira. "London relates to the Thames and vice versa, so to clean up the river will be a very wonderful thing."

The other priority of the company is health and safety. The CEO has a strong vision on this, to the point that if something cannot be done safely, the company will have to find another way to achieve the result. Even as treasurer, Madeira has been on a full-day safety course. Treasury supports the health-and-safety vision by being the enabler – on the cash-flow side treasury is responsible for all the payments and visibility over liquidity. Then there's the funding aspect to the project. "Although that debt comes a lot later in the project, it is up to the treasury to first set up the framework and then manage this and the relationships with all the key stakeholders, such as investors and the ratings agencies," he says.

As a company in its early stages, the big questions, such as what the treasurer is responsible for, what the CFO is responsible for and what should go to the board, are all open to discussion. "I look at the start-up nature of the company very much as an opportunity and, to be honest, this kind of fresh start very much attracted me to the role," says Madeira.

Having featured in the ACT's *Ones to Watch* for 2014, the chance to design a treasury department from the ground up is a fitting next step in Madeira's



“As a treasurer, pretty much every opportunity that you will have will come through your network or through executive search”

career. Speaking about his rise to the role of group treasurer, he acknowledges that networking is very important. “As a treasurer, pretty much every opportunity that you will have will come through your network or through executive search,” he says. “You can expand your network by speaking at conferences, building on your day-to-day work contacts, by being part of industry groups. The ACT provides a wonderful framework for you to expand your contacts in a variety of ways. You should do whatever works for you. But I definitely encourage my team to go to things like the ACT events whenever the opportunity arises, and to actively take the chance either to present or to network.”

Ben Poole is a business and finance journalist

PEDRO'S TOP TIPS FOR SUCCESS



“A treasurer should always be prepared to either ask for help, or even recruit it when needed. You will have your own area of expertise, your ‘angle’, and you will be a decent generalist, but no one can fully master or be an expert at everything.”



“I also believe that you should always reward good processes rather than good results. Treasury is a profession that has very visible results, but the focus should be on the processes: was this the right decision independently of the result, does this fit with the company’s risk strategy?”



“The AMCT has helped me in two ways. First, when I applied for an interesting treasury analyst position in Shell, I was the only one of 12 internal candidates who had the AMCT – it was the key factor in my selection. Second, today I’m in a position in which I regularly employ staff. When I see that someone has the AMCT, I know that they have a solid base level of knowledge across treasury.”



“My favourite gadget is my laptop. I am very old school in that regard. I even take it on holiday with me... my wife tried to convince me on the merits of tablets. So now we end up taking the laptop and two tablets.”



“The secret to my career success is actually something I am still working on. I tend to talk too much! So I am trying to listen more and to talk less.”



“My CFO always asks a very nasty question: ‘Why do you say that?’ He always wants to understand how sound the reasoning is behind what we are doing. This can be a challenge, but when you explain the workings and he agrees that it sounds right, you do feel a lot more confident. It also makes you think a lot more about why you do what you do.”

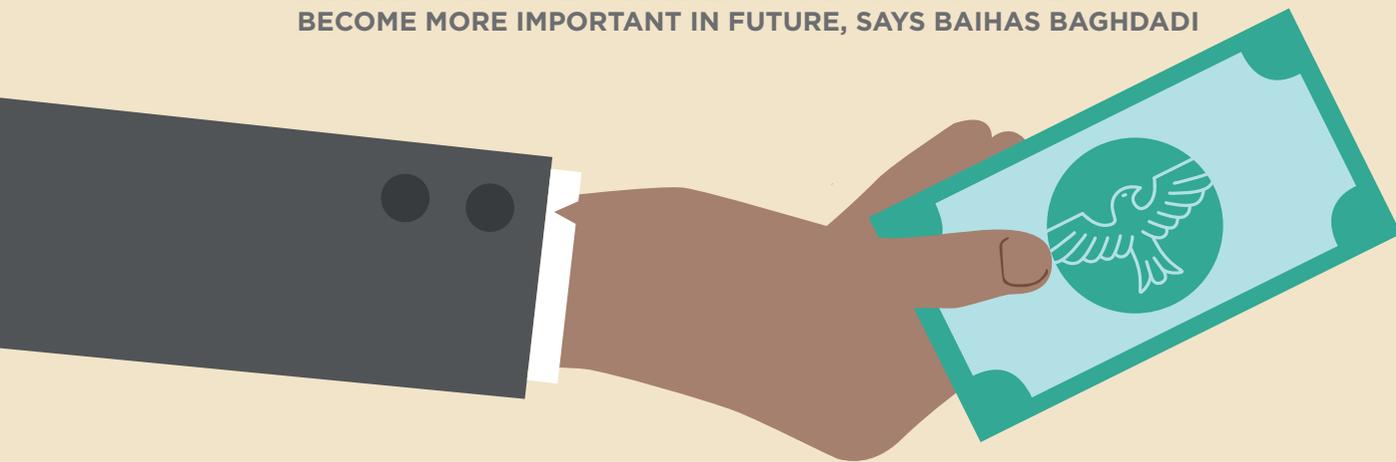


“The best way to unwind after a stressful day is definitely with a pint of beer in a pub close to the office by the canal. The location here is definitely an upgrade to the hotel bar next to Heathrow.”



THE LION AND THE FALCON

TRADE BETWEEN THE MIDDLE EAST AND AFRICA IS ONLY GOING TO BECOME MORE IMPORTANT IN FUTURE, SAYS BAIHAS BAGHDADI



Africa is, without a doubt, the territory where the biggest opportunities in international trade are arising. Nevertheless, perspectives differ as to the strength of the opportunities that exist and the best selection of countries to invest in within the region.

Much has been written about Africa and its potential. This is not surprising, since Africa is the region that has experienced the biggest growth in trade within the past 15 years. The continent already represents 6% of the trade activity in the world, and an estimated \$1.1 trillion of trade is linked with Africa, according to the World Trade Organization. Furthermore, Africa has a population of 1 billion, including 52 cities with a population of more than 1 million, and huge reserves of raw materials.

It is a mistake to consider Africa as a single, unique region, however. In reality, there are several different 'Africas'. Certain countries in the Middle East and North Africa may share a language and a culture but, with the exception of the Gulf Cooperation Council (GCC), they have very different trade frameworks. If businesses consider all African countries as a whole when they formulate their strategy, then that strategy is bound to fail.

African hubs

In international trade, there are three radically different strategies towards trading within Africa:

1) The first strategy is to directly trade with each of the 54 countries – to 'go where the opportunity

is' and take advantage of recent improvements in business conditions. Since 2005, all countries in the region have been adapting their laws to meet the requirements of the World

Bank. Progress has been especially significant in countries such as Angola, Botswana, Ghana, Namibia and Nigeria.
2) The second strategy is to trade through South

AFRICA'S GLOBAL TRADE FLOWS

Annual trade (\$bn)
2002/2014



Source: World Trade Organization (2014), Barclays Research

Africa, a country that resides within the African continent while having its own traditions and being an important market in its own right.

- 3) The third strategy is based on the principle that the United Arab Emirates (UAE) is the gateway to Africa, thanks to its strategic geopolitical position and its developed infrastructure.

South Africa (the lion)

South Africa, with its population of 53 million inhabitants, enjoys the most diversified economy in Africa. After developing its mining industry, it is now beginning to grow its energy sector. For this, it needs to build all types of infrastructure and improve its telecommunications, which represents an important strategic step forward for the country. In terms of attracting investment, South Africa has the clear advantage of being part of the African continent itself as well as being a major player with a demonstrated track record.

UAE (the falcon)

The UAE currently serves as the epicentre for the key trade corridors of Asia-Africa, Asia-Middle East and Europe-Africa. Furthermore, multinational companies favour the UAE's strategic geographical location, stable banking and financial environment, advanced logistics (supported by modern airports and seaports as well as storage facilities), free trade zones, business-friendly regulatory framework, and the access that they get to a qualified and professional labour force. It is for these reasons that many global corporates have established their regional treasury centres in the UAE.

The UAE has increased the diversification of its non-oil

GCI IN THE UNITED ARAB EMIRATES AND SOUTH AFRICA

	UAE	SOUTH AFRICA
Global Competitiveness Index (GCI) 2014-2015 (1 min - 7 max)	5.33	4.35
GCI (rank out of 144)	12	56
Change in GCI position since 2010	+15	+6
Stage of development (rank 1 out of 3)	3 (efficiency driven)	2.5 (transition)

Source: World Economic Forum (2014), Barclays Research

exports over the past decade. Meanwhile, the country's successful bid for Expo 2020, and its strong drive towards reforms, have anchored many initiatives that enhance competitiveness.

The UAE's differentiating factor is its socioeconomic future outlook, along with the pipeline of major infrastructure projects that distinguish the country from its rivals that are competing for the position of gateway to Africa.

Trade between Africa and the Middle East

Africa and the Middle East are benefiting from a clear shift in the direction of global businesses, which are increasingly emphasising intra-emerging market (or 'south-south') trade and investment.

Between these two regions, there are two evident synergies. The first is the growing number of investments from the Gulf region into Africa and the second is the increasing number of exports of machinery and equipment into Africa from the Gulf.

Slowly, but surely, Middle Eastern investors are expanding their African portfolios. Investment by Middle Eastern firms in Africa has so far been based on oil and gas, agricultural products and telecommunications. There has been a growing interest in more diversified investments across the continent, however.

The burgeoning relationship between the Middle East, particularly the Gulf, and Africa is borne out by the numbers. Data is patchy, but according to most analysts, trade between the Middle East and Africa has increased fivefold over the past 10 years, to record around \$60bn. South Africa is a good example of this growing dynamic. In 2014, 10% of imports into South Africa originated from the Middle East region.

According to a survey conducted by Barclays at the ACT Middle East Conference in November 2014, corporates from the Gulf currently hold a favourable opinion about the opportunities in Africa.

A significant number of corporates in the GCC seem to be expanding their exports and operations into Africa (Egypt, Kenya and South Africa are the most mentioned markets). Furthermore, the survey revealed that 25% of our clients in the Gulf region already have businesses in Egypt and 28% of them have operations in Kenya.

Yet survey respondents highlighted the principal obstacles that they face when entering the African market. These include the overcomplicated payment systems (20%), the legal and regulatory hurdles (34%), and liquidity and access to credit (20%). Interestingly, the lack of the right banking partners was the most

common challenge that faced corporates when they were looking for banks in Africa (40%).

In the future, the five key sectors that will drive growth in trade between the Middle East and Africa are natural resources, infrastructure, consumer goods, financial services and agriculture.

Opportunities for businesses are enormous if they correctly identify what to trade, which countries to invest in and which approach to follow (a hub in South Africa and/or the UAE).

Conclusion

The Middle East and Africa is a region that is rich with possibilities. It has a very promising trade horizon that makes use of the two components of the south-south corridor – sub-Saharan Africa and the Middle East and North Africa.

There are several government initiatives in the region that are dedicated to improving political and macroeconomic stability, which would eventually create a healthier business climate. Furthermore, due to positive trends within the global economy and within Africa's domestic economies, it is safe to say that the continent's long-term growth prospects are strong.

Nevertheless, growth opportunities and challenges vary across countries within Africa depending on the individual country's level of economic diversification and the strength of its export engine. 📈



Baihas Baghdadi is a managing director for Barclays. He is also the head of trade & working capital international and a member of the Barclays Global Corporate Banking Council

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Iraq: Two steps forward, one step back

HARSH ECONOMIC, INFRASTRUCTURE AND SECURITY REALITIES MAKE PROGRESS TOWARDS STABILITY FRAGILE. SEMIH OZKAN EXPLAINS

Iraq is marching towards a more sustainable economic position; however, progress looks much like the Ottoman janissaries' marches – two steps forward, one step back. The ever-increasing security and humanitarian crises have derailed the National Development Plan (2013-2017) and pushed 2015-2017 budgets into the red. Moreover, low oil prices have deepened the impact. Al-Abadi's government is undertaking efforts to fight this double whammy, but at the cost of infrastructure projects and reforms, both of which are needed to help the country realise its potential faster.

The cost of the crisis

The security and humanitarian crises, including, but not limited to, ISIS, have led to substantial costs to the country. The cost of the crisis is estimated at

\$90m per day¹, and increasing. For instance, Iraq has purchased 36 F-16 warplanes² (four of these arrived in Iraq in July this year). Iraq's defence ministry expects the warplanes to reinforce the military capability in its battle against ISIS. These are direct costs. At the same time, there have been devastating opportunity costs given to interruptions to projects across the country, most notably seen in those related to oil and connected sectors. This is significant, as Iraq earns more than 90% of its revenue from oil sales.³ Delays to projects will impact overall development and welfare prospects of the country. Iraq must maintain and further develop its technical and administrative ability to produce and sell oil in order to continue rebuilding the country. However, with the ongoing crises, Iraq has stepped back and appears

unlikely to meet production and export targets of 3.8mbpd and 3.3mbpd, respectively⁴ in 2015.

Deteriorating economics

The 2015 budget – based on a break-even oil price of \$100 per barrel (established by the International Monetary Fund – IMF) is already in deficit (forecast at c. 12% of GDP). FX reserves are being drained at an alarming rate, falling to \$59bn in 2015 from \$74bn in 2014.⁵ To help the country maintain a healthier balance of payments and to stop the deteriorating fiscal deficit, the IMF has fast-tracked the release of a \$1.24bn loan. There are strings attached, however.

The IMF requires more reforms to be undertaken; Iraq will need to revise electricity tariffs, make fiscal adjustments and seek out more financing sources. Steps are already

IMAGE SOURCE

being taken towards these, with the announcement of a \$6bn international bond to be issued by the Iraqi government. Citibank, Deutsche Bank and JPMorgan were appointed to structure the bond, according to a Bloomberg report. The bond is expected to not only help the budget, but also to restore some confidence in the long-term prospect of the country. Earlier this month, Iraq also received its first credit rating of B- from Fitch.⁶ Although the report cited insecurity, government ineffectiveness and weak institutions for the highly speculative rating, it will still help Iraq strengthen its ability to tap the market.

Doing business in Iraq: companies must focus on the fundamentals

Amid the turmoil, international companies are increasingly concerned. The situation has led to

a more challenging, and costly, business environment. Treasurers have a lot more responsibility now to steer the business in Iraq, while adjusting almost immediately to new realities. A solid long-term strategy, and very good banking and commercial partners, will help treasurers manage this delicate task.

Remain committed to the long-term strategy

The ongoing crisis has likely raised concerns in boardrooms globally regarding capital allocation and continued company presence in Iraq. While this is a right concern, companies need to look beyond current events and focus on Iraq's strong base of both natural and human resources. Iraq still has the fifth-largest proven oil reserves (c. 144 billion barrels⁷) and has the potential to become a major oil producer and exporter in the world.

Iraq requires significant investment across nearly every major sector to meet the country's primary needs. The National Investment Plan outlines incentives, rules and regulations for foreign direct investment into Iraq, while the National Development Plan prioritises sectors that require the most urgent investments. There is progress in almost every sector, but the challenge is not the crises per se, but the lack of a long-term strategy.

Find a good banking partner

Problems related to banking transactions are no rarity in Iraq and hence, a solid banking partner is critical to doing business there. There are more than 50

banks⁸ in Iraq and many suffer from decayed banking infrastructure, inadequate human resources, disrupted electricity and highly unsafe working environments due to ongoing insurgencies. Needless to say, one should temper expectations of any straight-through processing.

The banking system is dominated by two state banks, Rafidain Bank and Rasheed Bank, both of which require immediate recapitalisation in order to function effectively. However, it appears that the government has put this matter aside for some time. The country accesses international markets through the Trade Bank of Iraq (TBI) and the Central Bank of Iraq (CBI). These institutions are the lifeblood of the economy. Their roles are clear: the TBI primarily manages non-oil trade, while the CBI handles oil trade, among other traditional central bank roles and responsibilities. Foreign banks have limited operations in the country and typically operate through local partner banks, and there are instances in which a same local bank serves a number of international banks.

Companies' onshore banking requirements are limited to petty cash transactions and state-related payments. Other transactions are typically managed through offshore accounts in locations such as the United Arab Emirates. Cash is king in Iraq, and payments in US dollars are preferred to those transacted in Iraqi dinar. Cheques account for a small portion of payments and are not preferred due to potential delays in clearing. There are

a number of clearing systems in Iraq, including Real-time Gross Settlement (RTGS), Automated Clearing House, Checks Enablement Project and Securities Registration System, all of which are prone to disruptions, however. The RTGS is currently the most active system with the participants; yet achieving a straight-through process is still on a case-by-case basis. No FX-related restrictions (subject to the provision of supporting documents) and no tax or other charges are applicable. In trade finance, all the TBI's transactions are generally 100% cash collateralised or guaranteed by Iraq's ministry of finance. For companies, this means transactions issued by the TBI are practically risk-free, yet companies still find it difficult, rightfully so, to

Treasurers have a lot more responsibility now to steer the business in Iraq, while adjusting to new realities

assume direct risk of the TBI. As a result, companies pay c. \$2,500 to \$10,000 for every \$1m sales to mitigate bank and country risks.⁹ This is not only due to Iraq's country risk, but also due to the challenges of dealing directly with the TBI.

Companies must choose a partner bank that can persist and persevere with the needed ownership and follow up on clients' transactions from beginning to end.

Find a good local partner

Iraq ranks 170th out of 175 in Transparency International's corruption index and 156th out of 189 on the World Bank's Ease of Doing Business

ranking. It is important for companies to find a good local partner, one that can help navigate Iraq's legal, political and business environments.

Iraq's budget is already in deficit, which means lesser allocation for the works tendered. According to the International Energy Agency, international oil companies await c. \$27bn of recovery and remuneration fees from Iraq. In contrast, the current budget allocates c. \$12bn towards this header. Companies in non-oil sectors are also seeing a similar pattern. So companies can benefit from their local partners' endeavours to secure as much of the limited allocation as possible. Additionally, treasurers are better off in structuring trade finance transactions

in cooperation with their partner banks in order to avoid significant credit risk.

Pan-Iraq strategies, formulated by companies in early 2013, are being shelved due to heightened security concerns. At this time, companies must focus on their core businesses. Iraq is making progress, but there is still much work to be done. 📌



Semih Ozkan is an ACT student (CertITM) and a transaction banking professional in an international bank

1. According to the Brookings Doha Center, the initial estimate of the cost for 2015 is c. \$27bn. The humanitarian spending to support the displaced people alone is c. \$6bn in 2015.
2. www.meed.com/sectors/transport/aviation-and-airports/first-f-

16-deliveries-arrive-in-iraq/3212013.article
3. www.resourcegovernance.org/countries/middle-east-and-north-africa/iraq/overview
4. www.imf.org/external/pubs/ft/scr/2015/cr15236.pdf
5. According to the Institute

of International Finance and https://en.wikipedia.org/wiki/List_of_countries_by_foreign_exchange_reserves
6. www.fitchratings.com/site/fitch-home/pressrelease?id=989164
7. <http://graphics.wsj.com/lists/opeec-meeting>

8. www.cbi.iq/index.php?pid=IraqFinancialInst
9. An indicative calculation based on the actual experience where the international banks apply on an annualised basis from 0.25% to 1.00% on the cash collateralised transactions, ie confirmed letter of credit.



INTERCOMPANY LENDING ARRANGEMENTS INSIDE MULTINATIONAL ENTERPRISES ARE AT RECORD LEVELS, AND THEY ARE COMING UNDER INCREASING SCRUTINY FROM TAX AUTHORITIES ACROSS THE WORLD. SILVINA ALDECO-MARTINEZ AND ERNEST BREITSCHWERDT EXPLAIN

AT ARM'S LENGTH

For large multinational enterprises, intercompany lending offers the possibility of an ideal allocation of debt versus equity within the wider group to support shareholder value creation, an optimal capitalisation of entities within that group to meet investment requirements and the opportunity of leveraging these various entities' different levels of funding access.

However, the lack of a formalised framework for assessing and reporting intercompany financing has led tax authorities to identify a major risk stemming from it: that corporations are organising these transactions in ways

that could be interpreted as 'thin capitalisation', 'profit shifting' or other tax-avoidance practices (See *The Treasurer*, October 2015, page 34).

Although various national authorities have taken different approaches to such transactions, and there is a lack globally of a formal framework for their assessment, one common theme emerging, certainly in the advanced economies, is that such arrangements ought to be arranged according to the 'arm's length principle'. In other words, the aim is that the financing in question is conducted in the most objective way possible.

In showing that this is indeed the case, corporate

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groups in developed-economy jurisdictions are increasingly expected to demonstrate their compliance with two subsidiary principles.

The first is that the borrowing entity could and would potentially get access to a similar level of debt, with similar terms and conditions, from a third-party lender. The second is that the interest rate is priced in accordance with arm's length transactions in which comparable, unrelated parties would enter into similar agreements.

The benefit of such an approach is noted in the 34-nation Organisation for Economic Co-operation and Development consultation paper published in December

2014*: "An arm's length test... allows a tax administration to focus on the particular commercial circumstances of an entity or a group." The arm's length principle has therefore been found to be the most complete approach to formalise a framework for intercompany financing.

Risk assessment

Passing this arm's length test is a two-part process. Firstly, the enterprise concerned has to show that its *credit risk assessment* of the affiliated company is transparent, objective and comparable to that which would have been conducted by an unrelated third-party lender. Secondly, and assuming that the

financing is then approved in principle, the enterprise concerned then has to show that its *pricing of the loan* also meets these criteria.

The question is how multinational enterprises can best fulfil these requirements.

Firstly, the credit risk analysis. One simple way to arrive at a risk assessment is to calculate different financial ratios based on interest expenses, debt, equity, depreciation and amortisation (EBITDA), or assets in varied combinations. It is then possible to compare these ratios to aggregated ratio data based on those of publicly rated companies, and gauge the credit risk.

But this approach typically results in a flawed outcome. To start with, the publicly rated companies are likely to be of a different size and scale from the subsidiary or affiliate with whose financial ratios they are being compared to. Similarly, ratios are likely to vary across different industries and regions.

As a consequence of these issues, auditing firms and corporations have begun to incorporate a second

to be entirely unconnected to the main group.

The key role played by credit risk assessment in satisfying the arm's length criterion increasingly insisted upon by tax authorities is underlined by our own research into the risk landscape of the top 15 subsidiaries or affiliates of the five largest corporations, measured by revenue, with their headquarters in Luxembourg. These are ArcelorMittal, Tenaris SA, RTL Group SA, Regus plc and Eurofins Scientific SA.

These companies' interests range across five main industry groups: materials, energy, 'consumer discretionary', industrials and healthcare. These subsidiaries operate in at least two of these sectors and in a minimum of seven national markets.

Further approaches

This industrial and geographical variety can be shown when using a quantitative credit-risk assessment model calculating 'through-the-cycle' metrics in the form of probabilities of default or credit scores

LOAN RATES

Our own researches show interesting regional divergences in the spread between loan rates and bond rates. In the eurozone, the spread of loan rates over bond rates has risen markedly since the end of 2012, while the US markets display practically no mark-up in terms of loan rates over bond rates. One explanation is that the greater involvement of American companies of all sizes in the bond market has resulted in more competitive prices for loans.

What is certain is that the private-company loan premiums vary greatly over both different regions of the world, as has been seen inside the eurozone.

requirement. Depending on the tax jurisdiction, the additional consideration of a potential support structure might be necessary, based on qualitative and/or quantitative elements.

After the risk assessment follows the question of pricing the loan. That pricing needs to comply with the principle that the cost ought to be comparable with the rate that would be charged by an unrelated third party. Central to establishing this is ensuring that the price is similar to that charged in the open market

rates to be charged on loans. But a caveat is that publicly quoted bond rates tend to not reflect the extra risk premium that an independent private company would be expected to pay to lenders. It is here that an additional source of information can be brought into play: the secondary market in private loans. It is at the interstices of the public bond markets and the private loan markets where such a premium can be empirically quantified and estimated.

In conclusion, the rising use of intercompany financing and heightened scrutiny from tax authorities across the world have gone hand in hand. Increasingly, the requirement is that such financing will be conducted in a manner comparable to lending to an entirely unconnected company of the same size and creditworthiness.

Assessing the credit risk and the appropriateness of the associated pricing is not without its challenges. By leveraging sophisticated independent credit-risk assessment tools and mechanisms to compare observed prices for entities sharing the same credit risk, sector and country exposure, maturity and specific debt characteristics will help to ensure transparency, objectivity, consistency and speed, and therefore will limit potential conflicts with tax authorities. ♦

Assessing the credit risk and the appropriateness of the associated pricing is not without its challenges

approach, namely quantitative credit risk assessment models – effectively treating the affiliate as an entirely independent entity from the multinational business – to arrive at a far more credible credit rating.

Increasingly, auditors and companies have shifted to examining credit risk 'in the round' rather than focusing on financial ratios, with the most effective models looking at measures such as 'probability of default' and credit scores through the business cycle. These measures are more likely to produce robust and provably independent risk assessments of the sort that would emerge were the subsidiary or affiliate

(typically in lower-case nomenclature to distinguish them from public credit ratings) trained on observed defaults or ratings dispersion. These approaches enable a holistic assessment of financial and business risks altogether, rather than focusing on ratio analysis alone.**

The dispersion of the stand-alone credit-risk assessments we found in our research (ranging from credit scores of A- to CC) in conjunction with some substantial deviations from those of the parent companies is a clear illustration of the need to analyse each subsidiary or affiliate as an individual business in order to properly fulfil the arm's length

to independent companies with comparable credit assessments and operating in similar business sectors and geographical areas.

The public bond market, for instance, provides a valuable starting point to credit-risk pricing because of the availability of up-to-date price references (given the existence of a deeper secondary market), the depth of available coverage in terms of geographical and industry representation, and the full transparency of the comparable debt instruments, given their public nature.

Such a transparent, accurate and objective source of information is useful for establishing benchmark

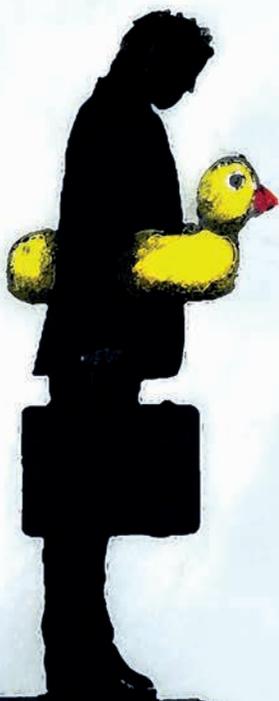
Silvina Aldeco-Martinez is managing director; and **Ernest Breitschwerdt**, CFA, is application specialist at S&P Capital IQ



*OECD BEPS Action 4: Interest deductions and other financial payments (Published 18 December 2014)

**The globally comparable output of these quantitative tools is typically considered independent and objective credit risk assessments, where judgement and therefore disagreement between multinational enterprises and tax authorities, is minimised

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Is the future liquid?

WITH CHANGING FUNDING PARAMETERS, NEW RULES IMPACTING THE ATTRACTIVENESS OF MONEY MARKET FUNDS AND PERSISTENTLY LOW INTEREST RATES, TREASURERS FACE A COMPLEX LIQUIDITY CHALLENGE. NICK BURGE CONSIDERS THE OPTIONS

Given the confluence of headwinds impacting the liquidity management space today, treasurers are using a wider set of instruments to manage their cash, and spending more time analysing their companies' liquidity risks and needs. They are optimising the composition of their liquidity buffer across the range of available credit facilities and investments.

While some companies may be struggling to access liquidity, many others, notably in the large corporate space, have access to significant liquidity. In fact, statistics show that across the Standard & Poor's 1200 Index (excluding financial services), cash and cash equivalents rose threefold

from \$1.22 trillion in 2000 to \$3.5 trillion in 2015.

Seizing opportunity

Since 2009, major central banks have followed quantitative easing programmes that have pumped billions into the financial system and have also held interest rates at multi-century lows. With the cost of debt at the lowest levels in living memory, corporate treasurers have understandably seized the opportunity to raise record amounts of capital over the past few years.

Often this will be earmarked to repay existing funding arrangements, to cover the costs of M&A, or to invest in the future growth of the company. But companies have

also been building liquidity reserves (buffers) to ensure they are protected against the financial consequences of unexpected events.

Black swan events are seemingly becoming more commonplace and the financial consequences growing ever larger, so it is not surprising that in aggregate corporate treasurers are currently managing the largest liquidity buffers in the history of the financial markets. This begs the question: how best to optimise the cost and to continue to meet treasurers' requirements of security, liquidity and yield?

Role of regulation

There are many factors that complicate the picture, not least

regulatory change. The most significant being the various bank liquidity and balance-sheet metrics in Basel III. Although directly targeted at banks, they have significant indirect impact on the end users of bank products.

Under the EU's implementation of Basel III (CRD IV), banks are subject to a number of metrics that impact on the corporate liquidity proposition. The liquidity coverage ratio (LCR) requires banks to hold high-quality liquid assets against a 30-day stress funding period. The stress factors being dependent on the type of client providing or using the funding. This impacts the relative value of different types of deposits and credit

facilities, etc. In the capital space, in addition to the risk capital requirement, banks are also subject to a leverage ratio, which particularly impacts on low-risk, low-return assets, and is changing the pricing dynamics and availability of certain products, such as repos. Furthermore, from 2018 banks will be required to meet a net stable funding ratio (NSFR), which requires more stable funding to be held against less liquid and longer-dated assets.

Under the LCR and NSFR, deposits and other funding from corporates are more valuable from a bank liquidity perspective than equivalent wholesale financial institution cash. Additionally, longer-term deposits have higher liquidity value than those falling within the stress window. All this means that while deposits from corporates of all sizes are important to banks, the very low levels of short-term interest rates negative in the case of the eurozone, mean that getting even a modest positive return can be a challenge for short-term cash.

LIQUIDITY MANAGEMENT CHECKLIST

Key questions for treasurers to consider:

- **How much liquidity does the organisation need to keep as a buffer should an unexpected expense occur or a black swan event happen?**
- **Does all liquidity need to be kept short term or can some of it be placed out for longer periods? If so, how long?**
- **Is the organisation's investment policy still fit-for-purpose in the current market conditions? Should consideration be given to products that the organisation has not previously used?**

geographies and product areas. Many multinational corporations' treasurers are therefore considering their counterparty mix in order to get the global and local coverage that they need.

Cash pooling and netting are additional aspects of liquidity management that are more challenging in the new liquidity environment. Banks providing pooling and netting services – in particular on a cross-border basis – need to ensure that they can properly offset the risk between cash positive and negative balances across different jurisdictions and

Given the record levels of cash on balance sheet, and very low level of global interest rates, many treasurers are looking to extend tenors. Given the plans and/or risks the liquidity buffer is there to meet, some treasurers may even be prepared to invest some funds for considerably longer than may have been the case in the past. Just as the availability of cash for investment is changing, so, too, is the range of instruments available to the treasurer.

Traditionally, money market funds were a key tool in treasurers' armouries, but their attractiveness as an investment

Liquidity management is only going to become a more significant part of the treasurer's role

In addition to Basel III, other regulations affecting global liquidity management include the Dodd-Frank Act, European Market Infrastructure Regulation and MiFID II, which are having an impact on liquidity in secondary markets. Corporates investing in securities will need to consider the liquidity characteristics of the instruments and the relevant markets. Another consequence of regulation is a partial reversal of the globalisation trend in the banking sector. Banks are subject to the regulations, and capital requirements, of the different jurisdictions where they operate, and many banks are looking to concentrate on a reduced number of

regulatory structures. Greater focus on ensuring legal certainty of offset is required.

Scope for treasurers

So, given the increasingly complex environment that they are operating in, what can corporate treasurers do to optimise their liquidity management? A good starting point is to re-examine the structure of the liquidity buffer, the balance between committed facilities and cash and other liquid investments, the tenor and product allocations of the cash, and then model how much really needs to be held overnight or short term and how much of the buffer could be invested over a longer period.

has been compromised recently due to the low returns on offer and increasing regulation in both the US and Europe.

As a result, more corporates are starting to use other investments, such as repos, or direct investment in securities. While repos are relatively simple, they do involve some additional documentation and infrastructure – once these are completed, repos are seen as low-risk investments that return a respectable yield in the current environment. Another benefit of repos is that they are one of the simpler forms of secured investment. Repos are essentially cash deposited with a bank secured by collateral, which (if high quality) makes them low risk.

New horizons

Some treasurers have cast their investment net even wider and are using investments such as asset-backed securities, commercial paper and short-dated corporate bonds. For those larger treasury functions with sufficient manpower and expertise to undertake the necessary risk management and credit analysis that go with this, the drivers behind such investments are clear. But for those running a smaller or less well-equipped treasury department, finding the time to become the company's asset manager as well as its financial gatekeeper is a tall order.

Perhaps, then, there will be a shift in the job requirements and opportunities for treasurers over the coming years as candidates with asset-management experience become more sought after. Or perhaps banks or other asset managers will be increasingly called upon to deliver cost-effective advice alongside in-house expertise.

Either way, it is clear that liquidity management is only going to become a more significant part of the treasurer's role over the coming years. To balance their expanding and more complicated remit, treasurers will require extra support in terms of budget, staff and expertise. They will also need to keep an open mind when it comes to new liquidity products and solutions, working with their trusted relationship banks to build a liquidity strategy that is flexible enough, yet sufficiently robust, to serve them well, whatever the future holds. ♡

Nick Burge is managing director, head of strategic liquidity, at Lloyds Bank Commercial Banking.



LLOYDS BANK

Cash forecasting is a process to identify receivables and payables, which enables an enterprise to manage its liquidity position. Identification of receivables and payables is important because it allows the enterprise to manage its working capital cost by reducing bank overdrafts or lending and to optimise its use of surplus funds. Being able to identify its obligations in advance means that an enterprise can optimise its cost of funding and investment opportunities from both a short-term and a long-term perspective.

Robust cash forecasting can lead to overall improvement in:

- Liquidity position;
- Cost of funds reduction;
- Use of excess balance;
- FX risk management;
- Management of short-term and long-term financing facilities; and
- Management of capital expenditure.

Various tools can be used for cash-forecasting purposes, including spreadsheets, specialist software and enterprise resource planning (ERP) systems. Alongside the tools that are used for forecasting, the strategy that is applied will also ultimately determine the usefulness of the forecasted information to the enterprise.

In most cases, it is not the cash-flow information such as currency, amount and account that are important; nowadays, an enterprise can derive much greater benefit from the transaction-, counterparty- and settlement-related information that can be associated with a cash flow.

Three approaches

Three main approaches to cash forecasting are:

BEST OF THREE

HOW CAN YOU COME UP WITH THE OPTIMAL SOLUTION TO YOUR CASH-FORECASTING DILEMMAS? AJAY ADITYA EXPLAINS



1. Transaction life cycle-based approach: This is a strategic, enterprise-level approach that requires various business units, such as procurement, sales, HR, finance and operations, to be integrated via ERP or specialist software.

A single transaction reference number is allocated to the transaction and the transaction carries this number throughout its life cycle, during the course of various different processes.

For example, in the procurement cycle, there will be the following processes: raising of a purchase order, invoice generation, goods acceptance, invoice payment, partial payment return, vendor refund and so on. Some of these events would have a cash impact and some would not have any cash impact. However, the same transaction number would be carried over.

Each process relating to the transaction is expected to enrich the cash flow with updated relevant information that would be of interest to treasury. The beauty of this approach is that treasury could have complete cash, transaction, settlement and counterparty-related information associated with the life cycle using a single transaction number from the start until the end of transaction. This is a huge benefit, since a single transaction number would unite multiple applications for various reconciliation purposes from transaction tracking through to instantly advising treasury of any obligation that the organisation has to consider, thereby providing enough lead time to respond.

This approach is best suited for large enterprises

with well-defined processes within business units that may exist in silos across multiple geographic locations. Implementation of this approach would lead to transparency on transactions, the purpose behind a transaction and the various status changes associated with it, counterparty information, the impact on foreign currency, any applicable netting opportunities, and receivables management.

With this approach, the enterprise has the freedom to define the life cycle based on the process maturity of the organisation and how it wants to use the details in the forecasted information.

For example, cheque processing can be segregated or combined with payroll processing based upon the organisation's requirements.

Various tools can be used for cash-forecasting purposes, including spreadsheets, specialist software and enterprise resource planning systems

So, if an organisation wants a view on the cheques paid to employees and vendors, then it can track this by combining the two activities together. On the other hand, if it does not want to track the payroll cheque processing, then only vendor cheque processing would be implemented.

There may be cases where transaction-level forecasting may not be possible – for example, in the US, securities settlement takes place on a net basis, thereby individual-level transaction status monitoring may not be possible from an end-to-end perspective. In such cases, this model needs to be modified.

2. Event-based approach: An event-based approach is best suited to a regional business

THREE ALTERNATIVE MODELS FOR CASH FORECASTING

- **The transaction life cycle-based model** caters to larger organisations in developed markets and brings benefits of real-time transaction tracking, additional information capture and reporting.

- **The event-based model** caters to mid-sized organisations in all markets and brings the benefits of transaction tracking at defined intervals and additional information captured on a 'best effort' basis.

- **The impact-based model** caters to specific business entities for which forecasting is required, based upon cost benefit analysis undertaken by the enterprise. It provides real-time transaction tracking along with capturing additional information on a request basis.

unit of a global enterprise or a medium-level enterprise. This is because it looks at the cash part of the transaction life cycle only.

Funding requests would be triggered, based upon a limited set of events identified in a transaction process, leading to the creation of cash advice. This cash advice would be sent with transaction-related information to the treasury of the regional

cash-flow event has been triggered, it would only contain information relating to the security and the client account details. Counterparty information may not be available until the money is credited to the client account and, depending on the implementation approach, status tracking and reporting across application may not be possible. Also, treasury would only be aware of the

from the transaction at the very end of its life cycle, which provides very little lead time for treasury to plan an adequate response in the most cost-effective manner.

This model is most appropriate for enterprises where processes are not mature and where cash forecasting is just required for a section of bank accounts or business units. In Asia-Pacific, this model is quite commonly used due to the more limited consolidation and size of enterprises that exist.

The three models cater to organisations at different levels of maturity and according to how well they would be able to use the information captured in funding requests. These models assume that funding would be requested at transaction level, however, there may be cases when funding requests are being extracted on a netted basis, which means they would lack transaction-related details and could not be further used for reporting and status update purposes. ❖

business unit or medium-level enterprise. A unique transaction number would be allocated that would link the transaction to the event that triggered it until the end of its life cycle.

The information carried by the cash flow is severely restricted by the availability of it at the execution of the event, since the transaction may not be carrying all of the vital counterparty- or settlement-related information at that point.

For example, in the case that a securities corporate action has been initiated in the form of dividends, then appropriate cash flow would be generated, since the dividends would impact the account balance. On the other hand, once the

cash-related impact once the event has taken place, reducing the lead time available in the life cycle-based model.

3. Impact-based approach: An impact-based approach takes care of the specific need of a business unit within an enterprise or a region.

Events would be identified and triggers created for advising treasury of the generation of cash funding. Then cash-flow information would be extracted based upon the defined events.

The information captured using this model is limited since transaction origination information may have been lost during the transaction's life cycle. Also, the information is extracted

Ajay Aditya has acted as a treasury consultant to global banks for more than 15 years and currently resides in Singapore



Toxic positions

TREASURY PROFESSIONALS SOMETIMES FIND THEMSELVES IN THE UNDESIRABLE ROLE OF SURGEON FOR UNWANTED, UNNEEDED AND PERHAPS ILL-ADVISED HEDGING POSITIONS. SCOTT RAE BURN SUGGESTS SOME REMEDIES

Financial assets that are worth either less than was originally paid for them, or less than the value they were expected to attain, are an unfortunate fact of life. Often it's not a case of one asset, but a portfolio of positions to be dealt with.

They can be referred to in polite company as legacy assets. For internal meetings we can be a little more direct and use a term like toxic positions. At home they are "that stinking mess that landed on my desk because nobody else wants to touch it".

They come from a variety of sources; some are generated for good reasons, such as planned long-term investments or hedging that was reasonably expected to be needed, or bundled in with an acquisition. Others come from not-so-good reasons like unauthorised, speculative (rogue) trading or even just errors. The cause, however, is just a historic detail and playing 'could have, should have, would have' will not make the situation go away.

Sorting out this kind of problem often falls to treasury, either because that's where the situation was created in the

first place, or because treasury is deemed to have greater expertise in dealing with financial asset positions.

There are four broad strategies that can be taken: sit and wait, clear-cut, controlled disposal or trade out.

But that's jumping ahead. Like a doctor with a patient, you have two principal tasks to perform: diagnosis and treatment selection. And they have to occur in that order.

Questions to assess:

- What assets are involved – forward contracts, options, rate swaps, shares, cash balances in devalued currency?
- How much value is involved? Not just the asset's spot value, but what it is currently showing at in the accounts or declarations to third parties – a now impaired nominal value?
- What are implications and constraints on different courses of action that we know about?
- Who else knows, or needs to know, about the situation? Do we need further technical support, funding or authority to deal with the situation? Does the CFO or bank need to



be advised? Is there a legal issue as well?

- When does a solution actually need to be in place? End of the day, month or year? When will any relevant cash flows or valuation impacts occur if no other action is taken? Options obviously time out; forwards need to be either settled or rolled; currency account balances or share positions don't in themselves have time constraints.
- Where within the business are the problem assets held? Are they within a central unit, or distributed within one or more areas of the actual business?

With a full assessment of the situation we can begin to see clearly what is actually there. Using timelines for when the fixed cash flows will occur for the different business units involved, we can draw a 'pain map' to identify what challenges lie ahead. Remember to include a bubble on the end of the timeline for cash flows that don't have a fixed date, such as selling shares you want to clear out, but don't have to. This would be the 'evil twin' of the business's normal cash-flow plan; combining the two would give early warnings of

Like a doctor with a patient, you have two principle tasks to perform: diagnosis and treatment selection

any liquidity shortfalls. As the medical profession puts it so well: 'first do no harm'.

Listing the various items to deal with, if it's a portfolio of problems, gives better granularity when it comes to selecting an appropriate treatment for each issue – they won't all necessarily be best handled in the same way.

A final couple of things to consider before beginning the actual clear-up: firstly,

are there similar problem positions out there that would be best dealt with at the same time? An amnesty period to get other issues on the table and sorted out before they become bigger problems might be a good idea, depending on the original cause of issue. Secondly, how the matter is being discussed internally might need to be addressed, especially if you need support for some of the required actions when people are worried about reputational damage from being associated with a train wreck, even if they're not responsible. Clearly labelling a clean-up and recovery situation as such might be embarrassing, but means it can be honestly treated as the necessary housekeeping operation that it is.

The treatment strategies each have strengths and weaknesses. The best one depends on the type of problem in relation to the business situation. And more than one can be used. As detailed in the box above, sometimes there is a silver lining.

The treatment strategies are as follows:

Sit and wait

Doing nothing is always a possibility, and might be

better than rushing into action simply for the sake of doing so. This approach is especially appropriate if a cool and calm assessment indicates that the current situation can't really deteriorate any further. A bought option position that is no longer needed and out of the money might not even be worth the effort of selling. Wait and let it time out and just book the premium.

MAKING THE BEST OF IT

Sometimes there are opportunities in adversity – be ready to find them.

Plan for a possible situation where some elements within a problem portfolio of assets can actually be released at profit (either when initially assessed or due to developing market situation, this will need monitoring). Optional loss date – talk to your tax professionals about when would be the best timing to realise a loss.

For issues already embedded in business, for instance liquidity impact from rolling a hedge at a really bad rate that the market has since partly recovered from, this might actually be worse than the current close-out... so a clean-up would at least look like an improvement.

Warning signs – does this relatively minor problem indicate there is something bigger and more serious out there? Catching it early might avoid it growing, or at least allow more time to find a solution.

However, in other cases inaction could be a really bad idea, for example, where somebody has written an option that should be covered at noticeable cost, rather than "gambling on survival" that it doesn't become a catastrophic loss.

Clear-cut

Simply shutting down all the problem positions immediately and walking away. The upfront financial pain is potentially highest, but if it's affordable, this approach allows a rapid return to concentrating on the real activity of the business. When there are multiple small hits to take, this might be the best option, rather than tying up a lot of time and effort for marginal savings.

Controlled disposal

Clearing positions on a preplanned timetable allows some more control as to when losses are realised, though that might mean the value impacts are less predictable. If it is to be effective, it requires accurate cash-flow estimates of both the problem assets and business. Otherwise it amounts to merely hoping the rest of the business can generate enough

to cover the loss from closing out positions.

Trade out

Treating the assets as an active trading portfolio, regardless of original intent, and releasing parts of them as and when the market moves to predetermined target levels. This gives more control over the value of impacts depending on the close-out levels selected, to limit loss or even generate a profit, but does so by giving up control of timing. When cash is limited, and the asset's nature doesn't dictate imminent cash flows, this method of clearing out the problems as and when they can be afforded might effectively be the only choice.

In summary: an accurate objective assessment of the situation and clear plan of how to deal with the challenges of toxic positions should help nurse your firm's finances back to health. Of course, if everyone had taken that approach in the first place there might not have been an issue to begin with. Time for some preventative medicine? 🍷

Scott Raeburn is a treasury professional in the industrial manufacturing sector

Finding treasure in a sea of data

LESLEY MEALL WONDERERS WHAT GEMS CAN BE FOUND WITHIN THE WAVES OF DATA THAT CORPORATES GRAPPLE WITH

Treasurers are only human. As the world becomes more digital and the treasury function becomes more automated, it can feel as if you are swimming against the tide in an endless sea of data – because you are. As well as creating this challenge, IT can, of course, provide solutions, in the shape of the many tools that are now available to help you to track and report on treasury performance and manage market events. However, treasurers need to be good swimmers.

“The source data that provides the underlying basis of cash, liquidity and risk management resides somewhere in the business and it is imperative that this data is accurate, timely and understood effectively. Without that underlying knowledge it is impossible to effectively manage an organisation’s liquidity and risk profile – in fact, imperfect data could very easily lead to an increase in its risk profile,” says Paul Bramwell, senior vice president of treasury solutions for SunGard’s AvantGard.

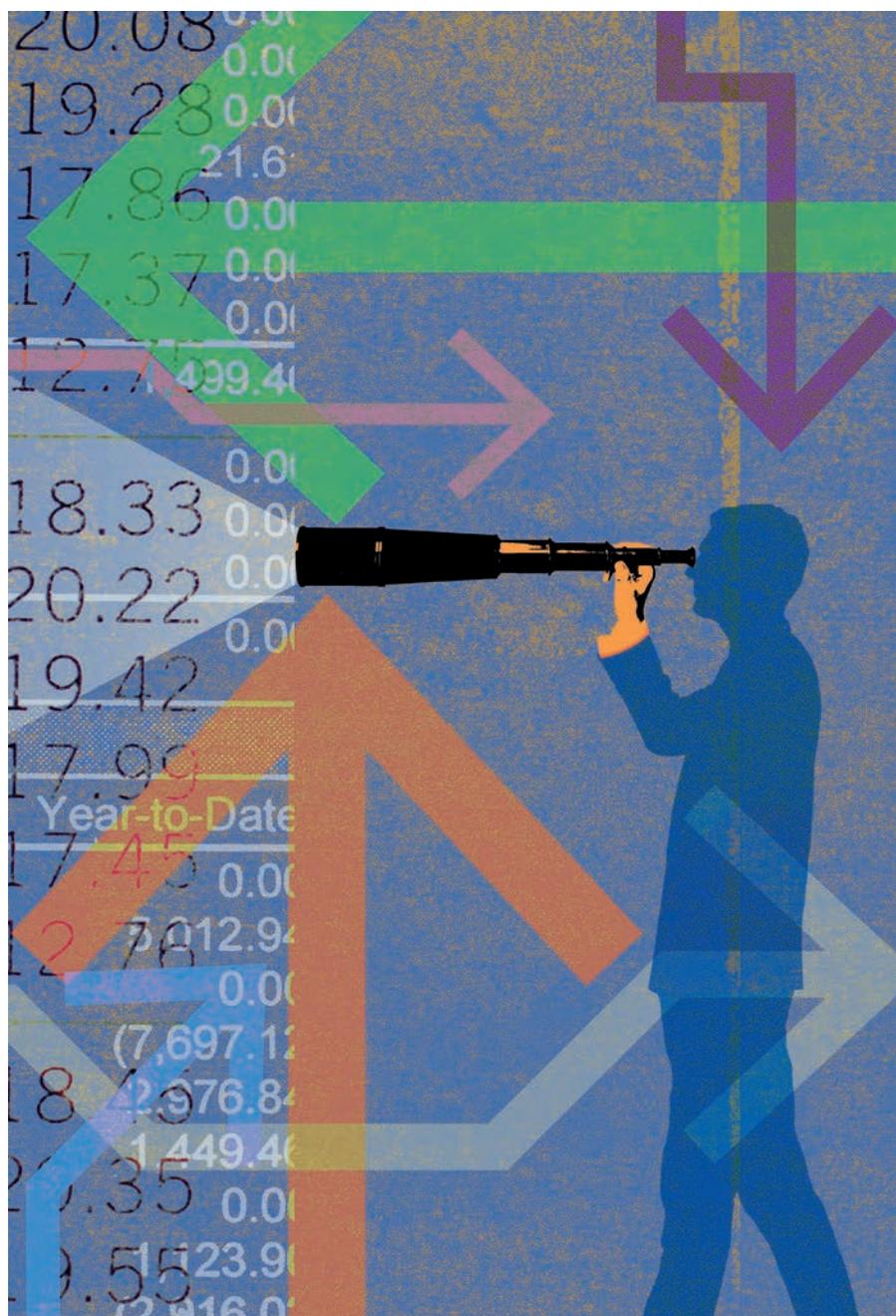
Once the source data is collected and collated into

a usable format, it can be summarised into ‘buckets’ of information that can be used to form a dashboard, showing key metrics that are recorded for use by treasury, the wider finance function and other parts of the business. But before you go diving into that sea of data, or selecting metrics and key performance indicators (KPIs), there are important matters to consider.

Aims and alignment

“We need to be very clear on a few things,” suggests Daniel Wong, head of global treasury operations at British American Tobacco (BAT), one of the biggest companies in the world, which has a globally centralised treasury function. It is important to identify the behaviours you want to monitor and manage – as this drives KPIs – and whether they are aligned to corporate strategy or controls. “Don’t measure things that aren’t important,” says Wong – not least because of the cost.

“There are massive costs related to managing a huge amount of data, so we collect what we need,” he says. He also emphasises the importance of data-management infrastructure



and the ability to analyse data quickly or in an automated fashion. Without this ability you can end up getting poor and late data (which is likely to translate into useless information), or you can spend too much on headcount to generate just a handful of reports.

With the basics attended to, you can focus on the treasury metrics and KPIs that are most important to those in the treasury team and to C-suite executives and managers in other parts of the business. So what are treasurers measuring? What do they have on their dashboards, and why? To some extent, this is determined by the software tools they have in place and the underlying data these have access to; but there are some metrics that many treasurers measure and monitor.

- Debt – by entity/credit rating of lender/undrawn facilities;
- Group liquidity;
- Breakdown of swaps, including mark-to-market and impact of interest-rate curve movements;
- Current hedging levels and projected future levels;
- Available security pool for future debt issuance;
- Key covenant compliance;
- Liquidity forecast out for 10 years; and
- Debt-maturity profile.

Fozard also produces a separate quarterly report to analyse bank charges.

“We have numerous KPIs, says Wong. For example, operational KPIs, such as bank fees and cash vs forecast, analytical KPIs, such as hedge performance or total counterparty exposure, or strategic KPIs,

and funding risk; monitors credit-rating projections and keeps an eye on the total interest rate and FX risk carried on the balance sheet. “These measures help us make sure that we continue to have access to funding at an optimum rate to pursue our corporate agenda,” says Wong.

The data infrastructure of a corporate and its counterparties may influence the metrics available to a treasury team and its potential usefulness. Some services leverage the vast amounts of transaction data that passes through bank pipes, along with complex algorithms, to benefit individual clients. Citi, for example, analyses client payments, then, if it identifies what it considers to be anomalies in the client payment flows,

down into the underlying data from the metrics and KPIs they are measuring and monitoring. “It’s not important for us currently,” says Turley. In contrast, Fozard says: “It is important for me,” and for a variety of reasons. “So that I can sense check that the data is accurate,” he explains, “and sometimes people want data cut in a slightly different way, so I need the base data when that happens.”

How much you can learn from drilling down and how useful this is may relate to the subject matter and the quality and completeness of the underlying data. For example, the counterparty risk element of a dashboard may show a summary of exposure to certain credit ratings. A drill down could show you which individual banks you are exposed to; a further drill down could show you which instruments you have with each of those counterparties.

For Wong, the importance of drill down depends on the subject. “For cash-flow forecasting, sometimes you want to understand the driver for particular shifts. For example, a period of business model change that results in unreliable receivables forecasting, etc.” Drill down is unlikely to involve static and reliable metrics. “We need to spend more time on more variable factors, and we can only see this if we can drill down into more detail,” he says. “We live in an age of data.”

“We can provide the client with the option to have a maker-checker on a particular payment, because we have flagged it up as suspicious”

“We measure the following key metrics within our monthly management information,” says Frank Turley, group treasurer, Legal & General Group. He lists:

- Financial performance (return on short-term investments);
- Cost of debt (actual and prospective);
- FX hedging (performance vs benchmark);
- Credit default swaps vs peer group;
- Credit rating vs sector; and
- Key rating agency metrics (leverage and cover ratios).

At Affinity Sutton, head of treasury, Ben Fozard, produces a monthly treasury report, which monitors:

- Cash – by counterparty/duration/interest rate/credit rating;

such as credit rating and long-term funding. It’s a constant challenge to make sure they are relevant and aligned to strategic objectives,” he adds.

Other examples of BAT group treasury low-level operational KPIs include hedging ratios by subsidiaries and currencies. There are payment KPIs, such as percentage straight-through processing for payments and treasury settlements. Targeted cash balances, investments and borrowings, and dealer errors, plus cash-flow forecasting errors for the short and medium term are also monitored.

At a higher level, the BAT group treasury looks at financing principles and metrics to monitor liquidity

these are reported on a client dashboard.

“This type of tool flags up areas where we feel more attention needs to be paid,” says Steven Elms, EMEA industrials sector head, treasury and trade solutions, Citi. It could be amounts, beneficiary, country or currency – and the client determines how sensitive the analytics are. “This is developing further, to include pre-release of payments,” he adds. “We can provide the client with the option to have a maker-checker on a particular payment, because we have flagged it up as suspicious.”

What lies beneath?

Perspectives vary among Fozard, Turley and Wong on the need to be able to drill



EMOTIONAL SMARTS

THE RECESSION MAY BE BEHIND US, BUT WORKING LIFE STILL DELIVERS CHALLENGES. GEETU BHARWANAY EXPLAINS HOW PERSONAL EFFECTIVENESS DEPENDS ON STAYING POISED UNDER PRESSURE

With the implications of the financial crisis still playing out, many organisations have been engaging in development programmes that focus on cultivating emotional resilience. This comes from a recognition that everyday challenges will only continue and that individuals need to operate at their full potential. M&As are back on the agenda and corporate governance is still very much front of mind, so there is no longer much certainty about where one's organisation will end up in terms of scale, scope of business activities and reach in the face of ambitious growth plans. Negotiating this environment requires a certain agility and ability to tune into emotional input and response.

This article examines what emotional resilience is and how treasury professionals can use an understanding of this topic to not only survive, but to thrive.

What exactly is emotional resilience?

The term emotional resilience has become more familiar in the workplace, but what does it mean and how does one become emotionally resilient?

I define emotional resilience as the ability to choose thoughts, actions and feelings that enable you to function at your best at individual, team and organisational levels. This is critical for finance and treasury professionals, who often carry governance responsibility for a business operating both profitably and ethically.



In addition to being technically strong in specialist knowledge and technical skill, treasury professionals need to master the emotional dimension of their interactions – that is, they need to understand the role emotions play in themselves and in others when working in teams. They also need a good sense of the emotional states in teams that support high performance and how they can be generated.

Emotional resilience in the workplace

More and more organisations and their leaders are grasping

the positive effect emotional resilience can have not only on their teams, but also on their own overall effectiveness as leaders, and the success of their organisations as businesses. Emotionally resilient people have the flexibility and know-how to deal with ongoing situations rather than one-off problems or crises and are the most consistently productive professionals.

Research has shown that by developing these skills, individuals are able to manage themselves and be resilient when working in teams, resulting in higher

SCENARIOS THAT REQUIRE EMOTIONAL RESILIENCE

- 1 Constructing a deal – being able to accurately read the people and the businesses involved.
- 2 Assembling a project team, while keeping in mind the need to identify accurately strengths and weaknesses of people involved.
- 3 Leading a team through a difficult and unexpected restructuring process.
- 4 Supporting a company to venture into new markets and advising executives of how to balance commercial ambition with solid due diligence.
- 5 Influencing a senior executive towards a different point of view while listening to their perspective.
- 6 Surviving a merger or deal that involves redundancies affecting team members, while continuing to work with existing and new staff.

performance. They are more likely to be visible as good work colleagues, effective managers and skilled personnel.

Organisations that ignore this vital ingredient will fail

to get the best out of their employees and their teams, which in turn has a negative effect on their bottom line.

To become emotionally resilient requires a combination of self-understanding and action. These are to be used not only in times of stress, but every day, to boost productivity and performance. It is not enough to just be 'resilient' and to bounce back, as many daily issues at work involve emotion, and many people do not have the strategies for overcoming more intractable problems. It is not solely about working on yourself – but understanding and building relationships with others.

How to develop your emotional resilience

The approach to developing and sustaining emotional resilience relies on developing an awareness of how we operate and cultivating the skills needed to negotiate difficult and emotionally charged situations.

Being self-aware

There are six aspects of emotion-related self-awareness that I believe influence what you think about and focus on, how you handle your emotions and those of others, and how you operate when working in a team.

- **Self-worth** – determines how you feel about yourself and how you function at work. Healthy self-worth enables you to connect well with others and to have good relationships.
- **Self-control** – is a matter of being able to keep your feelings under control in response to everyday work events. The steady stream of triggers that can cause reactions at work is endless – with emails, calls, texts and meetings being just a few. Our ability to deal with these distractions, our impulses, feelings and reactions depend on our self-control.

- **Mood** – is a reflection of our emotional state in any given moment. It's the atmosphere we create through our actions and inflict on others when in their company. Mood influences our choices about how we communicate, act and think. It affects those in our company and, when we are in a positive mood, it has a multiplier effect.
- **Empathy** – the ability to tune into other people's feelings so that we can take them on board when making decisions. It might involve taking a step back and understanding a different viewpoint, how another person might be feeling and responding appropriately.
- **Understanding** – being able to tune into what colleagues need in order for them to be effective at work. This is about knowing the working styles of others, understanding their personal context fully, so as to work together more effectively.
- **Caring** – showing that other people matter so that colleagues are able to make their best efforts at work; creating a feeling of compassion between individuals that surpasses empathy and understanding; doing what is right by people in the situation, not what is easiest.

By understanding these six essentials and reflecting on our approach to each of them, we can start to focus on the skills needed to build results in personal and team resilience.

Harnessing emotion

There are a number of practical skills that can be developed to enable us to take action, no matter what challenges are faced.

- **Shifting** – being able to recognise when our current emotional state is detrimental to the task in hand and that the situation requires a shift in mindset

CASE STUDY OF A DISENFRANCHISED PROFESSIONAL

Context

In the period after a merger, an outgoing CFO finds she needs to apply the framework of emotional resilience to manage herself through a difficult transition, as she works alongside an incoming CFO.

Reflecting on the essentials

In this example, the concept of **high self-worth** could be counterproductive, as it might distract the outgoing CFO's attention away from the task of establishing a new role for herself. She might instead find herself becoming unproductively competitive with the incoming CFO, for instance. She might also find that **low self-control** inclines her to react impulsively to unwelcome actions from the incoming CFO. **Low mood** could make her appear less than constructive in terms of assisting with the integration of the two finance teams. She might also find herself **low on empathy**, which is also a natural reaction. In this kind of situation, feelings of low self-worth, low self-confidence and a sense of being disengaged from work are entirely natural. In an ideal situation, the outgoing CFO would conduct a self-assessment against the emotional resilience framework to identify valuable self-management strategies.

Actively applying emotional resilience: mindset and skill set

Important here is the skill of **shifting** – moving away from feeling annoyed and rejected, towards building the necessary confidence to deal with the immediate situation and beyond. The ideal scenario would be to use this time to reflect on her own values and aspirations and affirm what will be most important her in her next role. When it comes to helping others, facilitating **group dialogue** is a useful means of supporting other team members. **Expressing** innermost feelings about the changes, on the other hand, may not be useful in this scenario; it is important the outgoing CFO remains very conscious of what she is communicating.

Using emotional resilience to deliver results

Now is the time to optimise personal and business **connections** to identify opportunities for herself and to make sure she is using her influence in a way that inclines others to refer her within their networks. Understanding and maintaining **energy** levels and focus, meanwhile, will help her to move on.

and approach to deal with it and improve the outcome.

- **Expressing** – being able to speak up appropriately when it matters.
- **Problem-solving** – being able to notice emotion and how to channel it appropriately.
- **Group dialogue** – being able to initiate difficult conversations when needed.
- **Group empathy** – tuning into and shifting emotions at group level to stay on track with work goals.

Once you have learnt how to identify the situation and actively apply your understanding of emotional resilience, you are able to start fine-tuning the key result

areas: connection, influence, energy and thriving (see case study above).

It is time to bring the skills and practices of emotional resilience into a much wider arena to influence changes in the workplace. As Charles Darwin discovered: "It is not the strongest of the species that survives, nor the most intelligent. It is the one that is the most adaptable to change."

Those who understand the role that emotional resilience plays in the workplace also understand that by embracing it and learning how to continually harness it to their advantage, they can operate successfully with those who are well-equipped to work towards their organisation's goals. ♡

Geetu Bharwaney is director of Ei World, a company that offers emotion-based development programmes for leaders





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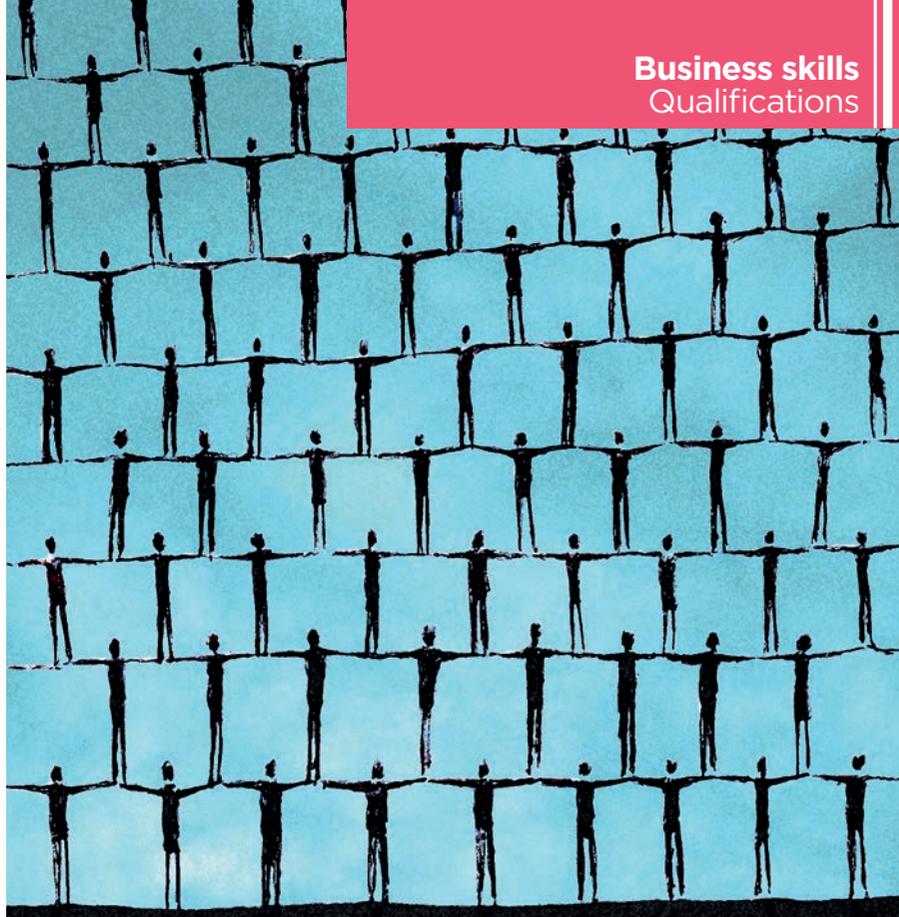


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Balancing act

Capital structuring and managing our organisation's cost of capital are essential treasury skills. Doug Williamson shares a powerful weighted averaging technique to improve the speed and transparency of this work

Calculating and explaining the cost of capital are fundamentally important parts of the treasurer's responsibilities. For this reason, they are regularly included in assessments for the ACT's qualifications.

Cost of capital

All companies are funded by equity capital and most also have debt. Each of these sources of capital has a cost, conventionally expressed as an annual percentage of its current market value.

Operating returns

The returns out of which our cost of capital has to be met or exceeded are the cash surpluses from our operations. Any projects or operations that don't achieve the cost of capital will destroy value.

So it is an essential practical skill to be able to calculate and explain cost of capital quickly and confidently, in order to evaluate new proposals and continuing operations.

Let's look at some examples.

Cost of equity

£3m of equity, costing a company 8% per annum, needs:
 $£3m \times 8\% = £0.24m$ per annum

This is the amount required by the equity investors. The equity investors' expected annual shareholder return is the same percentage of 8%, on their investment of £3m:
 $£0.24m \div £3m = 8\%$

Cost of debt

£1m of debt, costing the company 4% per annum after tax relief, needs:
 $£1m \times 4\% = £0.4m$ per annum

The cost of debt is cheaper for the company, but debt is also a more risky source of capital for the borrower. Equity is less risky for the company, but more expensive.

Weighted average cost of capital

The average percentage cost of all sources of capital in combination is calculated as the company's weighted average cost of capital (WACC). For a listed company, WACC changes continuously, as market values fluctuate.

A simplistic averaging technique would be to add up each of the items, and divide by the total number of items. However, this is normally too limited to give an accurate enough answer for financial evaluations.



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Instead, we need a weighted averaging calculation. The best weightings to use are normally current market values. This technique of weighting by market values has many useful applications in finance, not only WACC calculations.

Essential calculations

Calculations are also vital to gaining the ACT's qualifications.

For example, the Certificate in Treasury Fundamentals (CertTF) assessment requires you to answer and get right a minimum of eight out of the 16 calculation questions included in every sitting, as well as reaching the total pass mark.

All equity (100%)

Let's start with a case where the proportion of equity funding is 100%, and the cost of equity is 8%, as before. The weighted average cost of capital is simply 8%, the same as the cost of equity.

This would normally be the most conservative, safe and flexible capital structure. The safety and flexibility enjoyed are being paid for by a relatively high WACC.

Equal weightings (50%)

Another simple case is where the proportions of debt (D) and equity (E) are exactly equal. In this case the WACC will be exactly halfway between the lower cost of debt and the higher cost of equity. This relationship is illustrated in the see-saw diagram (above).

We can also set out the calculation in a table.

	Weighting	x Cost	= Weighted cost
D	2	4%	8%
+ E	2	8%	16%
= (D + E)	4		24%

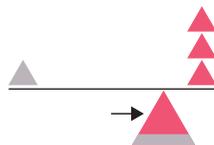
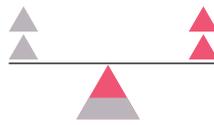
$$\begin{aligned} \text{WACC} &= \text{Total weighted cost} \div (\text{D} + \text{E}) \\ &= 24\% \div 4 \\ &= 6\% \end{aligned}$$

This is the weighted average when the weightings are equal. It is exactly halfway between 4% and 8%.

This company is enjoying a lower WACC, but it is a more risky and less flexible capital structure than all-equity.

Weighted towards equity (75%)

A more conservative compromise response would be to use a greater proportion of equity funding, perhaps 75%. Now the balancing point of our see-saw moves to the right. The weighted average moves closer to the equity cost of 8%.



	Weighting	x Cost	= Weighted cost
D	1	4%	4%
+ E	3	8%	24%
= (D + E)	4		28%

$$\begin{aligned} \text{WACC} &= \text{Total weighted cost} \div (\text{D} + \text{E}) \\ &= 28\% \div 4 \\ &= 7\% \end{aligned}$$

Changing the balance of equity to debt, in the direction of more equity, has increased the weighted average cost of capital.

The WACC of 7% still lies in between the debt cost of 4% and the equity cost of 8%.

Make sense of your answers

Having an idea of the range of possible answers is always good practice. It also gives a diagnostic of errors in calculations. Another benefit is that it helps to communicate our correct results.

Explain and influence

Getting the correct answer to a calculation is only the first step in practical work. We need to be fully confident in explaining the rationale and implications of our figures to colleagues and stakeholders. Transparent workings with intermediate figures expressly set out, as in the tables in this article, will greatly assist with communicating results and sensitivities.

According to our research, inexperienced treasurers fall short in skills such as presentation and influencing.

The Contemporary Treasurer 2015

Practise, practise

Test your calculation skills and understanding of WACC with this assessment question.

APP Group is funded by £5m of debt and £20m of equity.

Its annual cost of debt is 5% and the expected annual shareholder return is 7%.

What is APP Group's weighted average cost of capital?

- A 5.6%
- B 6.0%
- C 6.6%
- D 7.0%

(Based on Certificate in Treasury Fundamentals: Specimen paper, Q74)

The answer is C: 6.6%.

This is in between 5% and 7%, but closer to the equity cost of 7%, because APP has more equity than debt.

$$\begin{aligned} (5 \times 5\% = 25\%) + (20 \times 7\% = 140\%) &= 165\% \\ 165\% \div (5 + 20 = 25) &= 6.6\% \end{aligned}$$

Doug Williamson FCT, is a treasury and finance coach



The bailout lexicon



MANY FINANCIAL EVENTS AND ERAS ATTRACT THEIR OWN TERMINOLOGY AND JARGON – AND THE AFTERMATH OF THE 2008 FINANCIAL CRISIS IS NO EXCEPTION. SARAH BOYCE AND WILL SPINNEY PROVIDE A TRANSLATION AND LOOK AT THE IMPLICATIONS

New terminology regularly appears in the financial world along with an assumption that we will all magically understand the new concept.

For example, the regulatory authorities' approach towards financial institutions and 'too big to fail' has evolved as a result of the global financial crisis. Terms such as 'bank resolution' and 'bail-in' are frequently used and it is assumed everyone understands them. This article (extensively based on articles produced by the Bank of England) is intended to explain just what these terms mean.

During the global financial crisis, banks faced significant losses that reduced the value of their balance sheets to such an extent that they lost access to liquidity. This so seriously constrained banks' activities that the authorities were forced to intervene to stop banks from collapsing and taking the real economy with them. This intervention was provided in a number of ways:

- **Liquidity injections** – emergency funding to financial markets and individual financial institutions to ensure that they could continue to meet their obligations as they fell due.
- **Asset purchases** – selected asset classes, such as corporate bonds, were purchased from financial institutions to improve the liquidity of credit markets.
- **Liability guarantees** – public authorities guaranteed some liabilities, such as deposits or new/existing debts, to shore up confidence in the financial system.
- **Capital injections** – or 'bailouts' were provided in exchange for full or partial ownership of individual firms. Thus depositors were bailed out (saved) contrasting with 'bail-in' where they take losses.

In the US, 956 firms, including some non-financial institutions, benefited from some form of government assistance, amounting to date to around \$617bn.¹

In the UK, the support was more sector-wide, with specific support for only four banks, amounting to £1,162bn at its peak.²

Although this stabilised the financial system successfully, the cost was borne by the public sector and shareholders rather than the banks' depositors. Shareholders did lose because share prices fell

Bail-in hierarchy

Below is the order in the UK in which capital is bailed in to resolve a failed bank. Order of priority (from January 2015):

- Proceeds flow down**
- Fixed charge holders** (ie security in the form of: mortgage, fixed charge, pledge, lien), including:
 - Capital market transactions (for example, covered bonds)
 - Trading book creditors (for example, collateralised positions)
 - Liquidators** (fees and expenses)
 - Preferential creditors (ordinary)**, including:
 - Financial Services Compensation Scheme (FSCS), taking the place of all protected depositors for amounts up to £85,000
 - Employees with labour-related claims
 - Preferential creditors (secondary)**:
 - Depositors that are individuals and micro-, small- or medium-sized businesses for amounts in excess of £85,000
 - Floating charge holders**
 - Unsecured senior creditors**, including:
 - Bondholders
 - Trading book creditors (for example, uncollateralised positions)
 - Creditors with master netting agreements (net position only)
 - Commercial or trade creditors arising from the provision of goods and services
 - Depositors that are not individuals or micro-, small- or medium-sized businesses for amounts in excess of £85,000
 - FSCS, taking the place of individuals with funds invested with the insolvent firm (including protected amounts up to £50,000)
 - Unsecured subordinated creditors** (for example, subordinated bondholders)
 - Interest incurred post-insolvency**
 - Shareholders (preference shares)**
 - Shareholders (ordinary shares)**
- Losses flow up**

Glossary			
Ring fence	The separation of some aspects of commercial banking (mostly retail) into a separate entity to reduce the probability of failure.	BRRD	Bank Recovery and Resolution Directive (European law).
TLAC	Total loss-absorbing capital.	Bail-in	Where losses are absorbed by those investing in a bank.
Volcker rule	The rule in the US enacted into Dodd-Frank to prevent banks from engaging in certain risky activities.	Bailout	Where losses are absorbed by persons outside a bank.
Stress testing	Routine tests on banks to highlight risk of failure.	Hierarchy	The order in which losses are taken by those investing in a bank.
Resolution	Resolution is the process by which the authorities can intervene to manage the failure of a firm in an orderly fashion.	G-SIB/G-SIFI	Global systemically important bank/global systemically important financial institution.
Vickers Commission	The report that presaged ring fencing in the UK.	TBTF	Too big to fail.
Liikanen report	The report that presaged some separation of activities in Europe.	Top-down/single point of entry	Resolution starting at bank holding company level.
Commercial banking	Deposit taking and lending.	Bottom-up/multiple point of entry	Resolution starting at a bank operating company level.
Investment banking	Securities trading and proprietary trading.	MREL	Minimum requirement for own funds and eligible liabilities.
Moral hazard	An example of agency risk where managers take excessive risks knowing that their business will be saved by authorities.	Resolution weekend	The time in which a bank will typically be resolved, allowing it to open for trading on the Monday.

significantly, but they do retain a chance to recover their money. The key point is that depositors do not lose under a bailout, but might under a bail-in.

Following the financial crisis, central banks established a process to enable financial firms to be easily wound down if necessary, ie in an orderly manner, with continuing provision of financial services, minimal impact on other firms and no public money involved.

The process of managing the failure of a financial firm is called resolution. In order to ensure that the principal functions of a bank can be maintained, a number of stabilisation tools have been identified, which can be applied as part of the resolution process:

- **Private-sector purchaser** – the transfer of all or part of a firm’s business, which can include either its shares or its property, to a willing and appropriately authorised private-sector purchaser;
- **Bridge bank** – the transfer of all or part of a firm’s business to a bank, which meets the relevant conditions for authorisation, pending a future sale or share issuance; and
- **Bail-in** – the claims of shareholders and creditors are written down and/or converted into equity to restore solvency (ie they bear the cost). The write-downs are in a strict ‘waterfall’ of priority.

A bail-in, (previously missing in many jurisdictions) is similar in effect to a corporate restructuring under Chapter 11 of the United States Bankruptcy Code. It is intended to restore solvency and avoid the disorder that would result from the bank suddenly ceasing to trade while it is reorganised without calling upon public finances.

The powers set out in the resolution regime are designed to ensure that shareholders and unsecured creditors meet the cost of firm failure and that the authorities have sufficient flexibility to effect an orderly resolution as quickly as is necessary.

But safeguards apply, which will ensure that no creditor is left worse off than they would have been had the whole firm been placed into insolvency and secured claims are protected.

Bail-in, like the other resolution tools, can only be used when it is necessary to do so in pursuit of clearly defined public interest objectives.

Two landmark resolutions in the UK include Northern Rock plc and Bradford & Bingley plc. There have been two resolutions since 2009 in

the UK, namely, the Dunfermline Building Society on 30 March 2009, and the Southsea Mortgage and Investment Company Ltd, in June 2011.

What’s this got to do with the treasurer?

The main effect on the treasurer is most likely around how amounts due from the bank may be affected. Time deposits, certificates of deposit and current balances may be bailed in, as may ‘in the money’ derivative positions. Don’t expect that, because you have loans from the bank (bilateral or syndicated), the balances will be netted. You may lose money on a deposit and still have to repay the loan. If you enjoy letters of credit or guarantees from a bank in resolution, these may be at risk as well. If a bank under resolution has issued these on your behalf, they might need replacing.

Pooling, especially notional pooling where balances are offset, may also be affected. Pooling might in any case be more difficult under Basel III.

Conclusion

Bank resolution planning seeks to ensure that financial firms – whether large or small – can fail without causing disruption to payment systems and the normal support of trade without requiring a bail-in, thus exposing taxpayers to losses. Rather, the creditors of the failing banks should bear any losses, as they would do in insolvency, but without the financial instability and disruption to critical functions that the sudden insolvency of financial institution would otherwise cause.

By itself bail-in cannot guarantee that the resolution of a failed firm will be orderly. However, it can be used to stabilise the balance sheet of a failing firm until it can be restructured and, as such, is an essential component of a wider framework that, taken together, will allow authorities to intervene to manage the failure of large, complex firms in an orderly way. Treasurers must review their counterparty risk under these regimes. ♥

Sarah Boyce is associate director, policy and technical; and **Will Spinney** is associate director of education at the ACT

1 projects.propublica.org/bailout/list

2 www.nao.org.uk/highlights/taxpayer-support-for-uk-banks-faqs

Well, I'm astonished.
Gobsmacked.
Speechless even.

Anyone who is of a sufficiently masochistic bent that they read this page assiduously every month may recall that the very first 'Month End' column, about three years ago, lamented the possibility that cash would soon be abolished.

Blame Canada. The Canadians had decided to scrap copper pennies because the copper was worth more than the pennies. Then, in the UK, the Jeremy Vine phone-in show on BBC radio took up the arguments – and that was when I thought it was the thin end of the wedge. The end is nigh for our jingling coins and even our folding fivers once the massed ranks of the likes of Jeremy Vine get their teeth into this, I reckoned.

For treasurers, I think this seems a bit of a shame. 'Cash management' doesn't mean so much without any actual, you know, *cash*. Sure, these days it's almost entirely digital is and os anyway, of course.

But there's still more than 60 billion quid of the hard stuff kicking around – in jam jars, wallets, tills, trousers, that middle pocket between the front seats of your car...

But if my debut scribbblings on this page were meant as a mere flight of fancy, we now discover that life may imitate my art. No less a figure than the hugely respected Bank of England chief economist Andy Haldane (*for it is he*) gave a speech in September, in which he mused about the



CASHING UP (REVISITED)

Will the Bank of England scrap cash for 'Brit-coins'?

possibility of getting rid of traditional currency – all of it – and replacing it with a state-backed digital currency. Bitcoin, but with the Queen's head on it, if you see what I mean.

Why? Because in a super-low inflation and dodgy growth era like we're in at the moment, you can put interest rates down to zero, but it's a struggle to put them any lower. Haldane calls it the ZLB problem – 'zero lower bound'. Economist

John Maynard Keynes called it the liquidity trap. I know which I prefer. But either way, try putting the bank rate at *minus 3%* and you'll soon find everyone stuffing everything they have under the mattress, out of reach of a negative interest rate.

But if all the cash is converted into digital currency, hey, presto! The Bank of England can knock off a few basis points whenever it likes, regardless of where you have your cache of

MATT KENYON/KON IMAGES

'Brit-coins'. (Memo to self: has that name been trademarked yet? If not, do so.)

Haldane calls such a concept 'crypto-currencies'. I think 'klepto-currencies' might be more appropriate, if it means the bank can clip your digital dosh like a medieval moneychanger.

Last year, I teasingly suggested that Alex Salmond's dream of an independent Scotland was a country in search of a currency, while Bitcoin was a currency in search of a country.

Does Haldane now have even greater ambitions for the electronic lucre? Is he simply engaging in a little intellectual kite-flying, putting forward challenging ideas to help reach a deeper level of understanding of monetary policy? Or is Haldane dipping a toe in the water, testing the reaction to see whether it could actually be a popular move?

I honestly don't know what to think, so I'll have to turn to my very own 'digital decision generator' to help me reach a conclusion: *heads* I reckon he's just flying a kite, *tails* he's serious and he might just do it... ♡



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



IN THIS ISSUE:

The highlights of the November 2015 issue of *The Treasurer* include: **As cybercrime becomes more prevalent in society, what can treasurers do to protect their companies? Find out on page 18.** Thames Tideway Tunnel's group treasurer, Pedro Madeira, discusses setting up a new team from scratch, on page 24. **Three approaches can help you with cash-forecasting problems, on page 36.** Learn how being emotionally resilient can make you more effective at work, on page 42



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