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The latest approaches to customer authentication

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The best ways to assess short- and long-term cash forecasting

**BUILDING RAPPORT**

How to strengthen business and colleague relationships

# The Treasurer

THE MAGAZINE OF THE ASSOCIATION OF CORPORATE TREASURERS ◆ JUNE 2017

**“There is not an area of treasury untouched”**

Karen Toh, treasurer at the Grosvenor Group, on the business of transformation

**PLUS**

**THE ACT ANNUAL CONFERENCE**

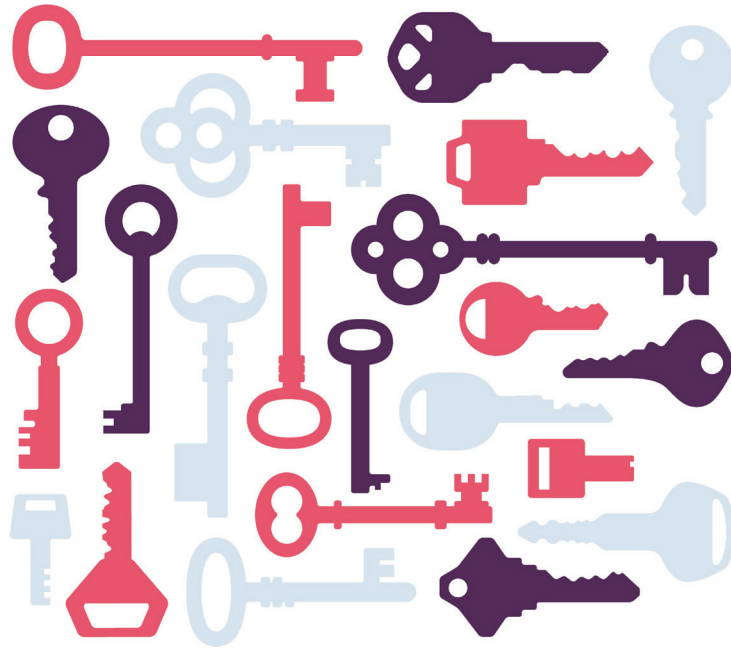
The speakers, debates and workshops that stood at ACTAC 2017



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## Editor's letter

Last month's WannaCry malware attack has been described as the most pervasive cyber-extortion attack ever seen. An array of high-profile organisations worldwide were afflicted – the National Health Service in the UK, Deutsche Bahn in Germany, Russia's Interior Ministry and numerous blue-chip companies. The speed and effectiveness with which this relatively low-tech attack spread has demonstrated emphatically that the systems we depend on can prove only too fragile.

Even before this attack, cybersecurity had moved centre stage and become a core concern for all. The ACT annual survey, this year renamed *The Business of Treasury* and published this month, found that it represented the biggest concern for their organisations for 83% of respondents. More than ever, organisations are turning to treasurers to help address cybersecurity matters.

At the ACT Annual Conference last month, presenters including cybersecurity specialist Jamie Woodruff set out the potential points of entry for hackers. Woodruff's point was just how easily hackers can exploit our behaviour and our oversights. Do employees always follow the rules on tailgating in and out of office buildings? Do they stray from their devices in cafés or in airport terminals? Do they talk about the business in public places? We'd like to think otherwise, but we know the answers to those questions are: 'not always' and 'sometimes'.

The conference, themed 'opportunity from uncertainty', provided many other perspectives on areas that are front of mind for corporate treasurers across the economic and political worlds, as well as opportunities for networking and debate. Turn to page 20 for our conference report.

This month, we talk to Karen Toh, treasurer at Grosvenor Group, about her treasury-transformation project at the real estate group. With worldwide interests, Grosvenor keeps its property management local, and Toh has overseen an impressively ordered rollout of a centralised and coordinated treasury approach covering workstreams, organisation, governance, systems, processes and controls, and reporting. Our profile of her begins on page 24.

This month's issue includes our cash and liquidity management supplement. We take a close look at how treasurers in complex businesses reach a clear picture on cash, the changing pressures on and role of banks, and at what kind of scenarios might prompt boards to look closer at cash and liquidity. Returning to security, we also look at the latest thinking on customer authentication. Our cash management supplement begins on page 29.

I hope you enjoy the issue.

editor@treasurers.org

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## THIS MONTH'S CONTRIBUTORS



**Jonathan Williams** is principal consultant at Mk2 Consulting. His career has encompassed product roles in

financial technology, telecoms and cybersecurity. He is now an independent adviser. His feature on authentication is on **page 34**



**Ian Tyler** leads the treasury advisory service at Alvarez & Marsal. He has more than 30 years' bank treasury experience

and writes and speaks on capital and liquidity risk management. His article on the changing role of banks is on **page 36**



**Stuart Duff** is a partner at business psychologists Pearn Kandola. He is a chartered business psychologist,

specialising in development, leadership and coaching. His article on building rapport appears on **page 50**

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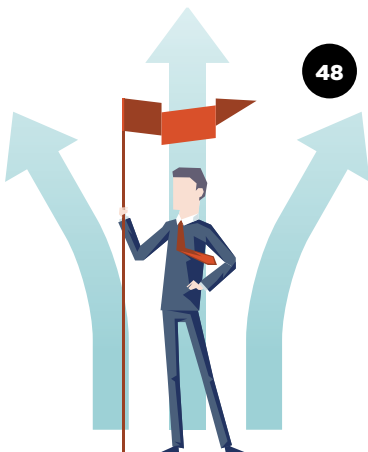
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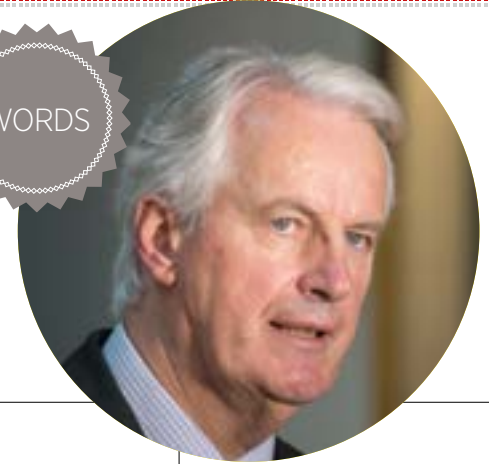
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{ ACT NEWS }

## TREASURERS' STRATEGIC ROLE GROWS

> The latest findings from the ACT's annual flagship survey, *The Business of Treasury 2017*, show overwhelmingly that treasurers see their role as strategic with the treasury function playing a key business role within corporates.

A resounding 88% of respondents told researchers that their treasury function was a strategic business partner within their organisation, and 36% said they work directly to define organisational strategy or work in close collaboration with colleagues to do so.

Researchers for the survey polled nearly 200 corporate treasurers worldwide in the first quarter of this year. They found the time spent on strategic issues by senior treasury professionals has risen by 60% since the ACT first began the survey in 2013.

Board engagement with treasurers has also increased. On average, acceptance of treasury funding proposals has increased over the same period from 63% to 84%. Capital and liquidity management and risk management are the two areas most frequently reported on by treasury at board level.

When it came to wider business issues, 83% said cybersecurity was the biggest concern within their organisation, with geopolitical uncertainty and volatility across financial markets also giving concern. However, 58% expressed concern about the quality of financial and business data available for strategic planning



and decision-making, and one third were concerned about senior-level experience when it came to addressing challenging areas.

"This survey provides clear and consistent evidence that the quality of communication, the

levels of trust and the effectiveness of treasurers in strategic financial management are being recognised by boards. What this means for treasurers is simple: there is a role for corporate treasury and treasurers at the highest strategic level within organisations, a role that plays to treasury's problem-solving skills," the report said.

To view the report, go to: [www.treasurers.org/treasurytrends](http://www.treasurers.org/treasurytrends)

**"The option of no deal or a bad deal does not come from me... We want to reach an agreement with the United Kingdom, not against the United Kingdom."**

Michel Barnier, the EU's newly appointed Brexit negotiator (pictured above), rejects the idea in a debate in the European Parliament, that either the EU or the UK should part without a trade deal.

SOURCE: REUTERS, 17 MAY 2017

{ TREASURY OPERATIONS }

## Professional bodies rally behind global FX codes

> The Global Financial Markets Association (GFMA) and the International Capital Markets Association (ICMA) have welcomed the final version of the Global FX Code, published last month.

A set of good practice principles for global FX market participants, the code has been designed to provide common guidelines aimed at promoting integrity and effectiveness across world wholesale FX markets.

Together with the UK Money Market Code, which the ACT's policy and technical team was involved in developing, the FX Code is intended to promote robust, liquid and transparent markets in which participants can operate confidently.

While neither code is binding, the ACT has been advising corporates to familiarise themselves with the details to better understand how they

apply to them and their counterparties when transacting in FX or money market fund markets.

Commenting on the Global FX Code, James Kemp, managing director of GFMA's Global FX Division, said: "Our members have already made significant enhancements to their conduct and control standards. For example, placing greater emphasis on the first line of defence, strengthening

the control environment and establishing more robust oversight structures. More emphasis is being placed on conduct training, as well as adherence to procedures and policies.

"However, there is no room for complacency. With the complete code now published, our members will continue to strengthen their technology, policies and procedures to ensure they align with the principles."

**"Disappointed by today's decision on the Paris Agreement. Climate change is real. Industry must now lead and not depend on government."**

General Electric CEO Jeff Immelt comments on Twitter on President Donald Trump's announcement that the US will pull out of the Paris climate accord.

WIKIMEDIA

**75%**  
of anti-money-laundering professionals surveyed said they believe the current climate brings new risk and challenge for their organisations



**54%**  
said they plan to increase their investment in regulatory technology (regtech) in the next three to five years

**48%**  
are relying on outdated technology

**59%**  
believe technology has improved their company's ability to tackle compliance issues



**57%**  
said availability of trained staff was a challenge

{ CONTEXT OF TREASURY }

## PRE-EMPTION GROUP REPORT

The Pre-Emption Group (PEG) has reported on listed company requests to shareholders to disapply pre-emption rights on share capital issuances.

In the *Pre-Emption Group Monitoring Report 2017*, the group looked at how closely UK listed companies have adhered to its statement of principles over the past year when requesting authority from shareholders to disapply the rights.

Pre-emption rights are enshrined in UK company law, and provide shareholders with protection against

inappropriate dilution of their shareholdings. The rights may only be disappplied when shareholders grant companies authority to do so, via a special resolution passed at company general meetings.

The report, which includes best practice guidance on engaging with shareholders and on disclosures post-issuance, found that out of 294 FTSE 350 companies that requested shareholder authority to disapply pre-emption rights, only one request was rejected and two others

were withdrawn. The group found only a small number of instances where companies failed to adhere to PEG principles or to use PEG template resolutions for their requests to disapply pre-emption rights.

The group, whose members include ACT chief executive Caroline Stockmann, recommends that companies use the statement of principles as a framework for their discussions and PEG template resolutions when proposing pre-emption rights are disappplied. "Companies not adhering to the expectations of the principles are less likely to receive the support of shareholders when putting forward subsequent disapplication requests," the report said.



**84,000**  
the amount net migration to the UK fell during 2016, the biggest year-on-year drop since 2012; 40,000 left the UK and 44,000 fewer arrived

**\$70 trillion**  
the size of the pensions time bomb within the world's biggest economies, according to the World Economic Forum



**18.2%**  
the fall in British car production in April, due to bank holidays and falling car sales



**80**  
the age UK workers may retire at in 2050, according to the World Economic Forum

**56.7**  
the high point on the IHS Markit index for eurozone manufacturing activity reached last month



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**"Moody's has overestimated the difficulties faced by China's economy and underestimated the government's ability to deepen reforms."**

China's ministry of finance responds to a downgrade from rating agency Moody's of China's long-term local currency rating.

SOURCE: THE FINANCIAL TIMES, 24 MAY 2017



**\$5.7bn**  
the amount Thailand has pledged to spend on an upgrade to its U-Tapao aircraft maintenance facility near Bangkok to meet increasing aerospace demand in Asia



{ AROUND THE WORLD IN 30 DAYS }

## PORTUGAL GDP; SINGAPORE DEAL; WTO ON GLOBAL TRADE



### Portugal out of special measures

The European Commission has said that Portugal is no longer in breach of EU budgetary rules. The country's budget deficit for 2016 fell to 2% of its GDP, which is below the European Commission ceiling of 3%. It is also the lowest deficit level since Portugal joined the euro in 1999, according to a report in the *Financial Times*.

The EU budget rules are intended to ensure countries work towards bringing their deficits down and reduce overall debt. They were made more stringent in 2010, following the banking crisis and the wave of bailouts that ensued. Portugal will now leave the EU's 'excessive deficit procedure', so only three countries – France, Greece and Spain – remain.

At the height of the crisis, 24 countries were in breach of the rules.

### ECJ rules on Singapore deal

In a closely watched case, the European Court of Justice (ECJ) has released its decision on an EU-Singapore free-trade agreement (FTA), stating that the deal requires backing from all member states only in relation to two investment issues.

However, the court ruled that the bulk of the trade agreement could be ratified at EU level, rather than unanimously by all member states.

In the UK, the Institute of Directors said the ruling would likely pave the way for a deal between Britain and the EU, potentially reducing hold-ups from individual member states.

The deal has been hailed as a new-generation FTA in that it covers intellectual property, investment and public procurement, as well as customs duties and tariffs.

### WTO bets on growth

The World Trade Organization (WTO) released its analysis on global trade, forecasting an expansion of 2.4% this year, but hedged its predictions slightly, putting world trade volume growth between 1.8% and 3.6%, with the potential for restrictive trade measures the main risk factor.

Trade growth should continue to pick up in 2018, it said, in a range of between 2.1% and 4%, following a weak rise of 1.3% in 2016.



{ TREASURY OPERATIONS }

## EBA WORKING GROUP EXPLORES CRYPTOTECH IMPACT

The Euro Banking Association (EBA) has released the results of its investigation into cryptotechnologies.

The EBA's cryptotechnologies working group has explored, in particular, the opportunities that distributed ledger technology holds for payment service providers in terms of lowering operating costs, modernising the international payments value chain and maintaining compliance with key regulatory requirements in markets around the world.

The paper, *Cryptotechnologies in International Payments*, looks at the impact of distributed ledger technology on KYC procedures, exploring the possibility of distributed KYC registers, as well as its use in relation to low-value P2P and B2C payments.

"Our information paper shows how this technology could support industry players in meeting user expectations regarding speed, transparency and cost," said José Vicente, deputy manager, marketing, cards and payments, at Banco Comercial Português, and chair of the EBA cryptotechnologies working group. "We strongly believe that collaborative initiatives in this area, in particular, could unlock significant value for payment service providers and their customers."

The EBA said security issues and assessing use of these technologies in international payments were the next priorities for study.

{ KEY FINDINGS FROM THE 2017 TREASURY FRAUD & CONTROLS REPORT FROM STRATEGIC TREASURER AND BOTTOMLINE TECHNOLOGIES }



**86%** of corporates have experienced payment fraud, cyber fraud business email compromise (BEC) fraud or ransomware in the past two years

**65%** of corporates have experienced fraud attempts in the past year

**81%** of corporate fraud was perpetrated by external, non-employee sources

**79%** of corporates have experienced BEC fraud in the past two years

**27%** of firms test their employees with fake phishing emails



MAKING THE NEWS

**Greek debt talks stall**

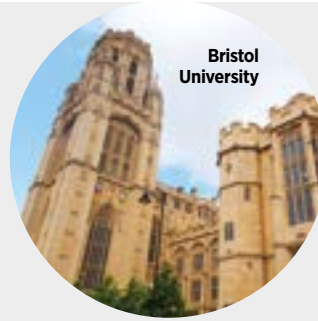
EU finance ministers and Greece's international creditors failed to reach agreement on a final deal for debt relief last month.

Creditors are believed to have rejected calls to provide an upfront commitment that would reduce Greece's overall debt, renewing fears that Greece will face a further cash crisis this summer. Greece's debt amounts to around 180% of its GDP and the economy is in recession once again. The International Monetary Fund had called for

debt relief, but key creditors resisted its arguments. Jeroen Dijsselbloem, head of the eurogroup of finance ministers, said the participants were close to an agreement, but all parties involved would need either to adjust their expectations or look at additional options. The talks will resume in mid-June.

**Swedish debt rattles central bank**

The world's oldest central bank has raised concerns about vulnerabilities in the Swedish banking system given levels of inflation and consumer debt. Increasing levels of mortgage debt is posing a critical threat to the Swedish economy, according to the central bank's stability report.



Bristol University

house prices could cause a fall in GDP and trigger similar results in other Nordic and Baltic states.

**Bristol University turns to bond markets**

Continuing a trend of UK universities turning to institutional investment to fund expansion, Bristol University has borrowed £200m to develop a new campus, expected to open in 2021.

The transaction is a 40-year private placement with Pricoa Capital Group, part of Prudential Financial in the US and comes at a cost of 3.1%.

The move follows Cardiff University's £300m bond issue last year. Bristol University's new campus will have an emphasis on technology and innovation.

SHUTTERSTOCK

{ TECHNOLOGY }

# STUDY INTO INTERNET OF THINGS OPPORTUNITIES IN PAYMENTS

Internet of Things (IoT) technology is set to radically change how commerce and transactions are conducted, providing it can address key challenges around managing volume payments securely, according to a white paper from research and advisory firm Celent.

IoT technology currently exists in the form of wearable tech, such as the Apple iWatch, and consumer goods that include user

interfaces, such as Amazon's Alexa and the Samsung Family Hub fridge. These items, dubbed order facilitators in the white paper, are set to proliferate and improve over the upcoming few years. The next stage of development comprises commerce orchestrators. These are expected to emerge over the next five to 10 years and comprise devices that prepare and executive transactions with user approval.

By 2025, we may see semi-autonomous economic agents, the report stated, ie devices



'Order facilitators', such as the Apple iWatch and Amazon Echo (below left), are set to proliferate

that act independently of their owners or clients, but in line with their needs.

The new technology will offer banks more ways in which to engage with customers and understand them better, the report said. However, orchestrating mass payments from a wide range of internet-enabled devices, securing payment

credentials against each one and ensuring security, authentication and support for micropayments are just some of the challenges the banking and payment industry faces.

There are many payment and commerce orchestration-related challenges to be addressed, from authentication and security to tailored

liability frameworks, said Zilvinas Bareisis, senior analyst at Celent's banking practice. "As always, creating genuine value for customers, rather than doing something just because technology is available, will be what differentiates successful banking IoT propositions from expensive failures."



Amazon Echo Dot 2 connects to Alexa Voice Service

SHUTTERSTOCK



**PICK AND MIX**

This month's briefing is a 'pick and mix' of a range of topics that were discussed at the recent ACT Conference in Manchester. Michelle Price and Sarah Boyce are the ACT's associate policy and technical directors and are always pleased to hear from you – whether with questions or with comments on areas of particular concern or interest to you. You can reach them at [technical@treasurers.org](mailto:technical@treasurers.org)



**Michelle Price (left) and Sarah Boyce (right) are the ACT's associate policy and technical directors [technical@treasurers.org](mailto:technical@treasurers.org)**



{ ONE TO WATCH }

## Blueprint for a new RTGS

The Bank of England, which has responsibility for operating the real-time gross settlement (RTGS) infrastructure, has announced the redevelopment of the RTGS system in response to changes in the payments landscape.

On an average day, RTGS settles around £500bn between banks – around 25% of the UK's annual GDP.

The largest flows are generated by CHAPS, the UK's high-value payment system, and it has been decided that the operation of this system will transfer from CHAPS Co to the Bank of England to improve financial stability. (This approach is consistent with that adopted in many other jurisdictions).

Most of the enhancements are due to be operational by 2020.

Further details can be found at [www.bankofengland.co.uk/publications/Documents/news/2017/newrtgs090517.pdf](http://www.bankofengland.co.uk/publications/Documents/news/2017/newrtgs090517.pdf)

{ CONTEXT OF TREASURY }

## Ring-fencing – do we have a plan?

Whether we like it or not, irrespective of Brexit, Trump and myriad other events buffeting the UK this summer, the reality of ring-fencing for UK banks is looming large.

Banks need to have their revised structures in place and operational by 1 January 2019. Eighteen months may sound like a long time, but in reality, when one considers the raft of changes that may have to be made, not only by banks, but also by their corporate customers, it feels like a pretty short time frame.

Most banks will be setting up their revised structures during the first half of this year, so if your bank hasn't yet explained what, if anything, ring-fencing (or bank structural reform) means for you, it should be on your agenda for your next relationship conversation.

The added complication in these conversations is Brexit – there's no escaping it, wherever

you are located in Europe. The banks need to work out how (or indeed whether) they will continue to provide services to corporates and where from, and corporates need to consider how their relationship group might alter over the next couple of years.

Also on that agenda, you might want to include:

- **The Global FX and UK Money Market Codes:** statements of best practice that all market participants (and that includes both corporates and banks) are



being encouraged to sign up to. For banks, these codes are likely to fall under the remit of the Senior Managers Regime (which embeds personal accountability into the conduct of regulated institutions).

The ACT is very supportive of these codes and will be issuing guidance on the best practice principles relevant to corporates and how the codes can be used by corporates to understand how their bank counterparties should be applying these principles. The ACT and Bank of England hosted an afternoon briefing on the codes for ACT members on 13 June.

- **MiFID II (also known as MiFIR):** your relationship banks should be able to explain changes arising as a result of MiFID II. Primarily focused on investment/issuance/trading. The recording of information, derivatives and capital markets activities may be affected.

{ TECHNOLOGY }

## CYBER - MATTERS

Cyber risk was one of the key topics treasurers wanted to discuss at the ACT's Annual Conference *talkingtreasury* session, particularly given how material the financial flows through many treasuries are and the introduction of cybersecurity audits to many organisations.

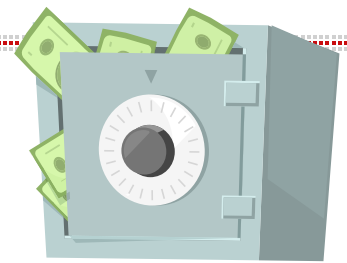
A range of resources are available that treasurers may find worthwhile:

- The UK's National Cyber Security Centre's web page has a broad range of guidance on how firms can protect their information and systems. See [www.ncsc.gov.uk](http://www.ncsc.gov.uk)
- The Financial Conduct Authority (FCA) has published useful guidance notes, information and speeches on cybersecurity issues for financial services firms,

which are equally relevant to corporate treasury functions.

**Topics include:**

- Guidance for firms outsourcing to the cloud and other third-party IT services;
  - The FCA's approach to cybersecurity in financial services firms (with a focus on large banks); and
  - The threat landscape for 2017 from the FCA's perspective.
- Links to these documents can be found at [www.fca.org.uk/firms/cyber-resilience](http://www.fca.org.uk/firms/cyber-resilience)



{ INTERNATIONAL }

## Basel IV

Basel IV is widely recognised as likely to have considerable impact on the banks – and, in particular, on the levels of capital they will be required to hold.

For corporates, Basel IV is also one to watch, as there may be an impact on charges or bank appetite as a result. Proposed changes to the models used by banks when calculating their capital requirements may result in large corporates (with consolidated total assets exceeding €50bn) being excluded from bank internal rating-based models and therefore becoming less attractive to banks.



**View briefing notes, technical updates and policy submissions at [www.treasurers.org/technical](http://www.treasurers.org/technical). Members can find our library of Brexit-related resources at [www.treasurers.org/brexit](http://www.treasurers.org/brexit)**

**For more immediate responses to events as they occur, the policy and technical team continues to write various blogs at <https://blogs.treasurers.org>**

**If you have a topic that's keeping you up at night and would like to be a guest contributor, please get in touch at [technical@treasurers.org](mailto:technical@treasurers.org)**



## Prospectus Directive – has issuing become easier?

In early May, the European Commission adopted new rules on prospectuses, which will come into force in 2019. The rules are aimed at lowering one of the main regulatory hurdles faced when companies issue equity or debt by simplifying the administrative obligations.

More details can be found at [www.consilium.europa.eu/press-releases-pdf/2017/5/47244659140\\_en.pdf](http://www.consilium.europa.eu/press-releases-pdf/2017/5/47244659140_en.pdf)

## The ACT Borrower's Guide to LMA Investment Grade Agreements

This fifth edition of the guide, produced by Slaughter and May for the ACT, has now been published.

The guide provides assistance to treasurers when negotiating loan documentation based

on the Loan Market Association's (LMA's) recommended forms and has been comprehensively updated for changes to the LMA's templates since the last edition. It gives a general overview for readers unfamiliar with LMA documentation, and a clause-by-clause commentary, which considers the implications of each clause from the borrower's point of view.

The guide also explores the key provisions and highlights common discussion points and addresses more recent developments affecting lending terms that treasurers may wish to take into account in negotiations with their banks.

The guide is available at [www.treasurers.org/LMA-guide-2017](http://www.treasurers.org/LMA-guide-2017)

{ REPORTING AND COMPLIANCE }

## EMIR REVIEW OFFERS RELIEF FOR CORPORATES



In early May, the European Commission published a proposal to amend European Market Infrastructure Regulation (EMIR), which will now work its way through the European Parliament and Council.

These proposals are an important step forward in reducing the regulatory burden on corporates and, if passed largely unchanged, offer good news for many.

A few of the headline changes include:

### Reporting obligations

- Transactions between a financial counterparty and a non-financial counterparty (NFC) not subjected to the clearing obligation can now be reported by the financial counterparty on behalf of both counterparties.

- Intragroup transactions, where at least one of the counterparties is a non-financial company, will no longer have to be reported.
- Historic transactions (ie those that were entered into before the start of the reporting obligation and that are still outstanding on that date known as backloading) will no longer need to be reported.

### Quality of data reported to trade repositories

- To improve data quality and transparency, trade repositories will be required to allow counterparties who have delegated reporting to another entity to view the data that was reported on their behalf.

### Clearing obligation for NFCs

- For NFC+s, the cross-asset class clearing threshold test will be removed and the clearing obligation will apply asset class by asset class.
- To lower the operational burden for NFC+s, these firms will now be required to assess their situation vis-à-vis the

clearing obligation only once a year, based on the average activity over the months of March, April and May.

On the cautionary side, the Commission has proposed that securitisation special-purpose entities should be classified as financial counterparties, something to watch out for if your organisation is involved in asset-backed transactions or securitisations on any scale.

The ACT press release can be found at [www.treasurers.org/node/333239](http://www.treasurers.org/node/333239), while the European Commission press release is available at [www.europa.eu/rapid/press-release\\_MEMO-17-1145\\_en.htm](http://www.europa.eu/rapid/press-release_MEMO-17-1145_en.htm)

The ACT has worked with a range of key decision-makers in the UK and Europe to help them understand the unintended consequences of the current EMIR regulations on NFCs – another example of our work in the public interest. If there is something you think we should be aware of, and helping decision-makers understand, please drop us a line at [technical@treasurers.org](mailto:technical@treasurers.org)

60-SECOND INTERVIEW



## RAJ BALARAMAN

SENIOR MANAGER, RISK ASSURANCE, PwC

### How did you get into treasury?

By chance, to be honest. I worked in IT, though I had an accounting qualification. Our corporate treasury team had an opening to grow and lead the technology aspects of treasury. I thought this was a great opportunity for me to specialise in treasury. It was one of the best decisions I have ever made!

### What do you like about treasury?

The ever-changing global environment and regulatory frameworks offer huge scope for treasury to contribute to the business – to better manage risks and enhance value.

### What's the best thing about being a treasurer?

Being dynamic – to be on your toes and to keep abreast of events; plus, to stay ahead of the challenges.

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

The ACT promotes a cohesive 'community', tailors its events and programmes to take care of all-round development of its members.

### Which ACT qualifications do you hold?

AMC.

### How has your qualification benefited you in your career so far?

The ACT gave me very good recognition in the industry. The qualification provided a foundation for my career in treasury.

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

Every challenge is an opportunity to grow. While adversities are difficult at the moment, they provide the best platform to learn and succeed.

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

You are setting yourself up for an exciting journey – be open to learn.

### What's your ultimate career goal?

Be a value-adding adviser to my clients.

### Who is your greatest inspiration and why?

Anyone who has turned their hurdles into their stepping stones. People like Helen Keller and Mahatma Gandhi inspire me.

✦ If you would like to star in our 60-second interview slot, email [editor@treasurers.org](mailto: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.



TRAINING, EVENTS & WEBINARS

### 2017 TRAINING COURSE DATES

#### 12 September, London

##### Treasury in a day

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

#### 13 September, London

##### Foreign exchange

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

controls that should be used to deal with those risks.

#### 14 September, London

##### Interest rate risk

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

#### 19 September, London

##### Working capital optimisation

Understand why working capital management is vital for the generation of sustainable cash flow and survival of all companies. Gain an appreciation of the techniques that can be employed to manage working capital and improve efficiencies within the supply chain. The course deals with the basic principles within payables, inventory and receivables management, and explores reporting implications for both smaller companies and larger enterprises.

#### 20 September, London

##### Cash forecasting fundamentals

On this interactive course you will learn how to review or completely redesign your cash-forecast framework and processes. Don't miss this opportunity to broaden your understanding of the fundamentals of cash forecasting. With increasing market volatility and business change, and access to financing harder and more expensive, organisations should focus on improved cash forecasting, to reduce unexpected, and potentially costly, surprises.

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

### ACT EVENTS 2017

#### 13 June, London

##### In Codes we trust: the new financial markets codes of practice

Join the ACT and the Bank of England for an afternoon briefing on the UK Money Markets and FX Global Codes. Senior representatives from the Bank of England, the ACT and financial market participants will provide an overview of the codes and discuss their relevance for corporates.

[www.treasurers.org/codes](http://www.treasurers.org/codes)

#### 27 September, Hong Kong

##### ACT Asia Treasury Leaders' Forum

Join more than 200 treasury and finance professionals from across Asia for the Asia Treasury Leaders' Forum to discover the latest developments in treasury tools, tactics and strategy. It is the perfect meeting place to share knowledge, experience and best practice, and build your professional network.

[www.treasurers.org/asia2017](http://www.treasurers.org/asia2017)

#### 8 November, London

##### ACT Treasury Forum

This invitation-only event is the perfect platform for leading treasury professionals to come together – sharing and debating the key issues of the day in an informal and interactive setting.

[www.treasurers.org/treasuryforum](http://www.treasurers.org/treasuryforum)

#### 8 November, London

##### ACT Annual Dinner

Taking place in the elegant surroundings of the Great Room at the Grosvenor House Hotel, this event provides you with a fantastic opportunity to network with your peers while enjoying a superb three-course meal, fine wine and entertainment in one of the most prestigious venues in London.

[www.treasurers.org/annualdinner](http://www.treasurers.org/annualdinner)

#### 21-22 November, Dubai

##### Middle East Annual Summit

Join us at the largest and most popular treasury event in the Gulf Cooperation Council. Bringing together the region's leading corporates, expect to meet more than 500 treasury and finance professionals, and hear thought-provoking insights and best practice from over 50 speakers, all under one roof.

[www.treasurers.org/middleeastannualsummit](http://www.treasurers.org/middleeastannualsummit)

### ACT WEBINARS

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✦ For details of our webinar programme, visit

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

## { CAR LEASING }

## JEREMY WARNER

Using credit to buy cars is ubiquitous – and an economic pile-up in the making

Of all the adverse consequences of the financial crisis, perhaps the most pernicious has been its depressing effect on earnings growth. All these years later, and in the UK real wages remain far below their pre-crisis level. According to recent forecasts by the Institute for Fiscal Studies, inflation-adjusted earnings are unlikely to get back to where they were prior to the crisis until at least 2021. This would make it the longest such hiatus in wage growth in more than 100 years.

Perhaps oddly, however, this doesn't seem to have had much effect on consumption, at least in the UK and the US, where there has been strong household spending growth for some years now. And, in particular, it has so far had zero effect on new car sales, which again both in the UK and the US, have been hitting repeated record highs.

Nor is this because, as has been the case with some other big-ticket items of consumer spending, prices have been falling. In fact, auto prices have been rising quite steeply with newer and more expensive models the purchase of choice for many consumers.

How can they afford these outlays? The question is answered in a single word: credit. Around 90% of cars sold today are purchased via personal contract plans



(PCPs). That represents a steep growth compared with 10 years ago, when less than half of car purchases were funded this way.

That growth is, in itself, salutary; no other area of consumer credit, including credit cards or personal loans, has grown as fast. In the UK last year, £40bn of car loans were extended, which means that after mortgages, PCPs are the second-biggest form of consumer credit. The phenomenon is proportionately even bigger in the US.

The simple reason for all this is the steady increase in car prices. The average car today costs around £20,000. Other charges associated with running a car – insurance and tax – have also been rising steeply. Normally, such a purchase would be a massive financial burden that few people are able to save up for. Enter PCPs. You may think you own the car; in fact, you are in essence merely renting it.

Auto manufacturers and finance companies are as enthused by this now quite well-established way of doing business as the consumer. It both helps the industry sell a lot more cars, and it offers finance providers what they like to think of as a relatively

risk-free way of expanding consumer credit. Now, where have we heard that before? Whenever bankers claim to have found the holy grail of 'riskless' lending, it's time to start worrying.

At the end of your contract, you either roll the arrangement over into a new one, buy out the outstanding value of the car or, more usually, hand back the keys and start again with another, newer model. The risks are obvious. In the US, which tends to front run the UK by a year or two on most matters economic, leased cars and trucks are being returned in record numbers so as to trade up to newer models, producing a glut of vehicles in the second-hand market, which is sharply depressing prices.

This, in turn, interferes with the assumptions on which the credit is based, threatening losses on many such contracts. In combination with record-low interest rates, personal contract purchases have helped push a seven-year stretch of increased US automobile sales, the longest such period since the launch of the Ford Model T in the late 1920s. It's beginning to look like a giant Ponzi scheme. We'll see how it all ends, but badly seems like a pretty sure bet. ♦

SHUTTERSTOCK



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

Enter PCPs. You may think you own the car; in fact, you are in essence merely renting it



**ACT**

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# How's the global economy doing? The hesitant upswing

## An imminent upturn in investment spending

Any first-year student of the dismal science learns that investment is the key ingredient to sustainable long-term economic growth. By forgoing consumption today to save and invest, economies accumulate the capital necessary to produce even more stuff for tomorrow. But investment is risky. Those with the means need to feel confident about the future before investing. Not everything that is produced is consumed. Economic agents are careful with their hard-earned savings. Nothing but these shifts in sentiment – the bull and bear animal spirits – drive the ups and downs of the economic cycle.

Resilience breeds confidence. After China worries failed to manifest in late 2015 and Europe sailed through Brexit last summer, heightened trust in the robustness of economic growth encouraged households to open their wallets and spend more freely. Starting mid-2016, global demand growth began to accelerate after years of sluggish growth since the financial crisis. Then came along Mr Trump, whose promises of fiscal and regulatory reforms further bolstered markets' expectations of an upswing.

However, seven years of modest growth driven by healthy gains in consumption and housing, but disappointing investment spending, have taken their toll. Unlike previous upswings, where firms have been quick to commit capital to get in on the action early, investment spending remains subdued.

Scarred by the excesses that led to the Lehman crisis, firms have been reluctant to pursue aggressive capital spending plans, despite low costs of capital and healthy cash flows. In all advanced nations, uncertainties about government policies have added to normal business concerns about sustainable product demand. Recently, some of those fears have dissipated. In the US, Trump's promise of reform has begun to stir confidence. Outperformance in the



UK economy has allayed fears. Growth in Europe has exceeded expectations. Most recently, the election of pro-EU reformer Emmanuel Macron has elevated the push for economic reform in France and in the EU more broadly.

Finally, the future appears more certain and fundamentals look healthy. The ongoing upswing in the developed world is broad-based and synchronised. It would take a major shock to derail it. Meanwhile, high stock market valuations, rising revenues and profits from strong demand, and low costs of capital thanks to accommodative monetary policies, provide a solid foundation for capital investment. Now, diminished uncertainty and heightened confidence add to those positives.

After weak growth last year, key leading indicators for investment, such as firms' expected sales over the next 12 months,

**The US economy has the final say on the pace of global growth**

have turned up sharply across major parts of the developed world. This is encouraging. If investment spending picks up, it will complement sustained healthy consumption growth over the course of the year. Over time, this can add even more momentum – and longevity – to the upswing.

How long will it last? US tax reform is critical. If the Trump administration can reform US corporate taxes, by reducing rates and expanding the base, and, critically, enacting the expensing of new investment,

capital investment growth will jump. This would boost US productivity and potential growth.

While emerging giants like China and India have closed the gap in recent years, the US remains the most systemically important economy in the world. For better and for worse, the US economy has the final say on the pace of global growth. If Donald Trump and Paul Ryan disappoint, the false dawn would likely trigger firms in the US, and elsewhere, to roll back planned expansions.

But if Trump delivers, an acceleration in US economic growth will reinforce the economic upswing in the developed world. It would be nice to put the age of caution behind us. Time will tell. ♥



**Kallum Pickering** is senior UK economist at Berenberg Bank



LEARNING  
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{ ACT ANNUAL CONFERENCE }

# CAROLINE STOCKMANN

The ACT's chief executive on new beginnings

What a great event it was – my first ACT Annual Conference! Meeting speakers, delegates, sponsors and exhibitors really expanded my understanding of the vital role the ACT plays in inspiring conversation and debate around a whole variety of hot topics – we are not short on those – for treasurers, as well as connecting stakeholders who want and need to know what's up in the world of corporate treasury. Whether it's regulatory matters, Brexit, cybercrime or technical solutions shown via case studies, I found it all fascinating. And not to forget leadership and diversity – the topics that actually really make the difference between a high-performing organisation or individual, and a mediocre one.

Although a UK-based event, there is an increasingly international flavour to, and participation in, the annual conference, which I hope we can build on going forwards. It will be very important for us all as we enter into new territory after Brexit. There is also a broadening of representation, which I hope will continue. The number of corporate delegates was up this year and we also had a greater variety and number of organisations represented. I think some of our exhibitors were surprised to learn that a charity that works in more than 100 countries and has a turnover of \$1bn is actually



a significant business. And, moreover, the very same issues and challenges face it as do a multinational corporate.

I enjoyed the *talkingtreasury* slot very much, with its interesting debate on digital currencies. We are looking forward to next year to see how we can create more space for this kind of discussion during the event – as well as more opportunity for sponsors to engage socially with their clients. So there can be something more for everyone. Having said that, it is always a balance – and I spoke to one treasurer who came solely to meet exhibitors and another who does not want any contact with sponsors at all. We have a great diversity of thought on the matter.

I enjoyed the *talkingtreasury* slot very much, with its interesting debate on digital currencies

I was really pleased to hear that the new two-day format worked so well for you, with less time out of the office, and am looking forward to seeing the full analysis of delegate and sponsor feedback – so we can adapt for next year as appropriate, in the vein of continual improvement. I think most will agree it was a content-packed two days, so my only regret was that I could not attend everything and meet everyone. Next year cannot come fast enough for me! In the meantime, we have our Asia Treasury Leaders' Forum in Hong Kong in September, and our Middle East Annual Summit in Dubai in November, with more overseas events in the new year – so lots more people to meet and ideas to share.

I am really looking forward to it all, as well as our fantastic annual dinner, which sounds like a very impressive event, and a great opportunity for me to meet even more treasurers.

ROGER HARRIS

As always, if you want to introduce yourself, tell me your thoughts on the ACT, or the voice of treasury in general, do not hesitate to contact me at [cstockmann@treasurers.org](mailto:cstockmann@treasurers.org)

I cannot write this piece without, of course, referencing the tragic event that took place only days after we left Manchester. Many thanks to all our overseas friends who have sent their condolences and messages of support, and I know the whole treasury community joins me in keeping the families of those who lost their lives in their thoughts. ❤️



**Caroline Stockmann,**  
ACT Chief Executive



LEARNING  
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## 2017 COURSES

Competency	Course	Sep	Oct	Nov
Corporate governance	Treasury security, control and audit		31 -	01
Risk management	Foreign exchange	13		
	Interest rate risk	14		
Corporate financial	Mechanics of corporate funding		11-12	
	Investing corporate cash		4-5	
Treasury operations	Treasury in a day	12		
	The A-Z of corporate treasury			13-17
	The nuts and bolts of cash management		16	
	Advanced cash management		17-18	
	Working capital optimisation	19		
	Cash forecasting fundamentals	20		



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## { GREEN BONDS }

## SARAH RUNDELL

More development money should be reaching environmentally focused projects. Time to put some impetus behind green bonds

➤ Tech giant Apple, Japanese car maker Toyota and the Spanish utility Iberdrola may be very different companies, but they all share one recent initiative. They've all issued green bonds, the corporate bond issue where the debt goes on financing environmental benefits for the company.

In Apple's case, its inaugural \$1.5bn issue last year will include funding the company's conversion to renewable energy and an increase in the use of biodegradable materials. Toyota's \$1.75bn issuance in 2014 has funded consumer loans and leases for green vehicles including hybrids like the Toyota Prius. At Iberdrola, and many other utilities, green bonds have financed renewable energy projects.

Green bonds help companies diversify their investor base and show commitments to sustainability, yet celebrated issues aside, corporates overall have been slow to go green when it comes to issuing debt. The green bond market grew by more than \$80bn in 2016 to \$170bn, admittedly its best year since its launch in 2007. Yet outstanding green bonds still account for less than 0.2% of the \$100 trillion global debt market.

Businesses share responsibility for the emissions driving up temperatures that



will increasingly affect their bottom line. And investors are looking at environmental sustainability more and more when deciding where to park their capital. Isn't it time to bring green issues to the forefront of corporate treasury's consciousness? Companies may have sustainability policies in place, but they may not be embedded throughout the business, and the chances are they stop at the door of treasury and the board.

**What is Green?**

Corporate treasurers have good reason to be reticent about green bonds. There's still no regulatory body with the authority to say what constitutes green, leaving investors nervous of green washing and financing unsuitable projects. But parameters have been set in frameworks laid out in

the Green Bond Principles established by a group of financial institutions including BlackRock, JPMorgan and the Climate Bonds Standards. And other initiatives are gathering steam. The Bank of England and People's Bank of China are collaborating under an initiative spurred by the G20 leading economies to improve certification procedures. Two credit-rating agencies have also led initiatives to evaluate green-bond issuance, and now the Financial Stability Board has established a taskforce to produce guidelines for voluntary disclosure and improve climate-related financial reporting.

Treasurers worry about reputational risk if they can't deploy the funds quickly enough to green causes. How best to successfully measure the environmental impact of an investment is also a concern.

But here steps could include indications of the environmental benefit like standardised metrics showing the emissions savings per bond. Third-party reviews

of projects and their results would be another way to increase transparency. The Apple bond is unusual in having an annual audit from EY on how the proceeds are being used. Toyota updates investors on a monthly basis to show how its money is being deployed. So rules and metrics are emerging to both guide corporate borrowers, and increase investor transparency.

Liquidity is another problem. But in a catch-22, the issuer base won't grow if corporates stay on the sidelines. Thankfully, governments are paving the way for more corporate issues by showing companies how to do it. France issued its first green bond earlier in the year and has identified around €10bn of green investment. Poland became the first European sovereign to issue a green bond at the end of last year.

Chinese companies are leading the pack, selling the most green bonds last year, totalling \$33.6bn, according to HSBC. Issuance of green bonds jumped after the signing of the Paris climate agreement in December 2015. And now China, the EU and India have been quick to reiterate their commitment to the agreement since Trump's withdrawal. Let's hope more corporate treasurers hear the calls to rally around the climate deal and give the green bond market the boost it needs to go mainstream. ♥

SHUTTERSTOCK

**Corporate treasurers have good reason to be reticent about green bonds**

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

# UNCERTAINTY AND FORWARD MOTION

The political context, the potential outcome of Brexit negotiations and the speed of technological change were key themes at the ACT's Annual Conference

Taking as its theme, 'opportunity from uncertainty', the ACT's Annual Conference, held in May in Manchester, roved over the political, economic and business landscape, reviewing technological and regulatory change, as well as upheaval in what has become a fast-evolving world climate. As broadcaster and news anchor Huw Edwards, who chaired the Question Time debate on day two, put it: "There's plenty of uncertainty around. The questions are: how much opportunity is there? And, what do you identify as opportunity?"

## Keynotes

The conference kicked off with an energetic presentation from Lord Michael Dobbs. The conservative peer, once Margaret Thatcher's chief of staff who was famously sacked by her in the run-up to the 1987 election, is best known as author of the political trilogy, *House of Cards*. In his keynote address, he turned his sights on global geopolitical uncertainty and the position of the West in relation to emerging economies.

Lord Dobbs argued that current debate on this subject is often blighted by a pessimistic outlook and set about dismantling arguments he considers dominated by groupthink. He gave

Words: **Liz Loxton** / Photos: **Roger Harris**



Lord Michael Dobbs

a vigorous defence of the West's standing in the world.

First under the knife was the received wisdom of China's uncontested ascendancy. "We are constantly told that Chinese expansion is a threat. Well, perhaps," he said, "but China is also grappling with problems associated with rapid growth." With huge

numbers still in poverty, and considerable issues with corruption and pollution, China has its own sources of instability. The real threat to the West lay in the possibility of its implosion, he argued.

Russia, likewise, grapples with extensive internal tensions with a declining GDP, an ageing population and shrinking natural

resources. While not seeking to downplay the significance of President Putin's moves in the Crimea, Ukraine or in Syria, Lord Dobbs argued that Russia's standing, like China's, was not guaranteed. "Time is not on his side and neither is the oil price," he said.

An issue the West does need to grapple with, he argued, was understanding the nature of the post-millennial generation. This generation has grown up in a post-9/11 world and has never known the world prior to terrorist strikes on the US and Europe, in particular. And while technology puts the world at their fingertips, post-millennials are almost too aware of uncertainty, he said. Within this generation there are deep paradoxes and, at the same time, great potential. Post-millennials are intensely competitive, but have smaller expectations, he said. The significant upside in that lies in the fact that they are less likely to be impressed by the promises of politicians. "Perhaps that will inspire politicians to do less, but to do it better. Perhaps those with a longer-term view will get a hearing, those with a strategy rather than a quick fix," he said.

The evolving political backdrop was picked up in the following keynote, given by Paul Watters, senior director at Standard & Poor's, and Monique Ebell, associate research director

**"Perhaps those with a longer-term view will get a hearing, those with a strategy rather than a quick fix"**

## ETHICAL HACKING – Jamie Woodruff

Ethical hackers, a breed of IT specialists sometimes referred to as 'white hats', ply their trade by carrying out sanctioned assaults on the technology infrastructures of corporates and other organisations in order to assess their vulnerabilities.

Ethical hacker Jamie Woodruff gripped delegates with his presentation on cybercrime and in particular the role of social engineering. A key part of his approach rests on his technical abilities in combination with an understanding of employee behaviour. Fact gathering, people-watching and technical

know-how together have enabled Woodruff, technical director at Metrix Cloud, to fulfil assignments such as reaching and entering supposedly secure server rooms within client premises.

Corporate extortion via cyberattacks is big business, he reminded delegates, and data has become more valuable than currency. Despite heightened awareness of the dangers, tricks such as dropping USB keys enticingly labelled 'company bonuses' are sometimes enough to prompt otherwise switched-on employees to plug unknown accessories into company hardware



Ethical hacker, Jamie Woodruff

and potentially download malware.

Ransomware is big business and hackers are now highly organised, much in the same way as their corporate targets. Businesses that suffer a ransomware attack find themselves in touch with call centres where a hacker will talk them through a Bitcoin

purchase in order to pay off the ransom and give instructions on how to carry out steps to retrieve data or repair breaches.

Stressing that all the incursions he has made into buildings and systems have been ethical and carried out with consent, Woodruff went on to point out that the vulnerability

of corporates often comes down to human behaviour.

In spite of tailgating policies, for instance, Woodruff has gained entry to buildings by striking up conversations with employees outside, gaining their confidence by demonstrating knowledge of the company, its current projects and its personnel, and then following them into the building.

Research, observation of employee behaviour and technological know-how are a powerful tool, he said. Constant vigilance and awareness of the tactics of hackers will remain essential in the fight against cybercrime.

at the National Institute of Economic and Social Research (NIESR).

Watters and Ebell gave a post-Article 50 analysis of the UK's strengths and opportunities. Ebell focused on free-trade agreements. She modelled potential outcomes for the UK economy in terms of what it stands to gain or lose depending on the final terms of Brexit and the success or otherwise of trade negotiations elsewhere.

Assuming the UK could negotiate agreements internationally, we could expect the export of goods to increase by 26%, she said, via lower tariffs. However, given that the EU

## Each industry sector would have its own watch points in relation to Brexit

has provided a strong export market for services, those gains may not balance out losses in service exports to the EU.

That said, the presence of UK technology and other intellectual property within the world's complex international supply chains is a feature of the business landscape that is not properly reflected within trade figures, she said, and the UK's competitive position would continue to benefit from its participation in this area, she argued.

Watters revisited the importance of this aspect of the UK economy. "The vision will be for the UK to



become an even more critical link in a global high-value supply chain, spanning goods and services," he said.

Each industry sector would have its own watch points in relation to Brexit. The UK aerospace industry is a case in point. Heavily dependent on world trade with 90% of goods and technology generated exported, aerospace is the UK's poster child in productivity terms, with a 30% growth between 2010 and

2015. However, the sector's concerns include the potential for increased tariffs across the eurozone, access to skills and its place within the European Aviation Safety Agency.

### Technical review

While keynote and plenary sessions focused on macro themes, workshop presenters delved into treasurers' day-to-day issues.

A session on FX risk management, for instance, >

The ACT hub was a focus for delegates within the exhibition hall



BREXIT ROUND TABLE

Peter Goshawk, the ACT's incoming president



The subject of Brexit was never far from the conference agenda. On day two, a Brexit round table, facilitated by incoming ACT president, Peter Goshawk, considered different outcomes, their likely impact on access to capital and talent, and the changing risk profile of corporates in the face of hard or soft exits from the EU.

Moritz Kraemer, global chief ratings officer at Standard & Poor's Global Ratings, set out Brussels' structure for negotiations. The European Council will remain in charge of strategy, while the European Commission will handle negotiation. Brussels has announced two stages for negotiations, with stage one – covering

the land border with the Republic of Ireland, rights of EU citizens in the UK and of UK citizens based in continental Europe, and the relationship between the UK and the EU post-Brexit – to conclude in the autumn.

The S&P view, he said, was that Brexit is a lose-lose proposition for the UK and for the other 27 member states. The UK stands to see a fall in income, not only from the export of its services, but also in terms of foreign direct investment, from which it has benefited more than any other member state. "The uncertainty is unprecedented and the risk of negotiations breaking down should not be underestimated," he said.

James Rudolph, deputy treasurer at Centrica, said the

utility's links with Europe, a growth area for the business, made Brexit preparation a difficult area. The significant amount of energy imports and membership of the EU's Emissions Trading System are both areas where Centrica is heavily involved with the EU. The treasury function has been involved in anticipating and modelling different potential outcomes. The ability to continue to access capital and skills is central. "If London hollows out, we will lose that access, especially to skills," he said.

Himanshu Kher, group treasurer of IG, commented that for financial services firms that passport into Europe, the final detail of Brexit would be of considerable importance. It also

meant facing up to questions such as whether the business would need to move to another financial centre or open a subsidiary elsewhere, which also has implications for access to capital, liquidity and specific banking services, such as credit facilities and hedging arrangements.

George Duncan, head of group funding at Scottish & Southern Energy, says "The UK's electricity infrastructure requires significant investment. A period of stability is required to maintain the confidence of energy investors in the UK following a period of volatility in the political and regulatory environment."

A question from the audience prompted the panel to consider advantages to Brexit. The panel agreed the referendum vote had forced fundamental discussions within their operations about evaluating new markets and rethinking customer and product strategies. A forced change can sometimes give impetus to projects that otherwise might remain unrealised, they said.

explored how more and more corporate treasurers are looking at risk holistically, with senior management increasingly embedding that approach into KPIs. According to a CitiBank survey, only 49% of corporates surveyed have clear sight of their FX risk, so technology as a risk management enabler continues to be a strong theme going forward. Erik Johnson, director at CitiFX Global Risk Management Solutions, described how corporate treasury functions are making strides in terms of working with data that typically would not have been captured a few years ago.

The question of operating in an era of continued low interest rates was the theme of another session. While increases in interest rates are widely expected in the US, and with the European Central Bank expected to start withdrawing fiscal stimuli, the panel debated the changing parameters and explored whether interest rate rises were a threat or an opportunity.

Presentations elsewhere looked at the increasing traction of green bonds and socially responsible investment, the possibilities likely to be brought in by the EU's Payment Services Directive and the open-banking technology underpinning it plus methods

**"The uncertainty is unprecedented and the risk of negotiations breaking down should not be underestimated"**



Delegates networking at the event



Huw Edwards chaired the Question Time session at this year's event

## THE CONFERENCE IN TWEETS

### Caroline Stockmann

Great to see so many treasurers in one room!  
@actupdate #ACTAC17

### Clarissa Dann

A whole generation not seen high interest rates and treasurers force discussion of this risk  
@actupdate #ACTAC17

### Deutsche Bank GTB

Corporates want fair fees, expertise, agility, innovation and stability from their banks.

### Victoria Bell

Post-millennial generation have never known a world without "the war on terror". "Normal" isn't coming back. @dobbs\_michael #ACTAC17

### Andrew Deichler

Weale: Even with the worst Brexit can throw at us, there are still opportunities for businesses. #ACTAC17



Delegates met up with old acquaintances and made new connections at the ACT Annual Conference in Manchester



## The question of operating in an era of continued low interest rates was the theme of another session

of detecting and mitigating payment fraud.

### Question time

The conference's lively Question Time session, chaired by Huw Edwards, examined the political issues that are front of mind for corporate treasurers closely tracking the political agenda. Questions including: how was it that politicians could tell such fundamentally important lies about important issues and not suffer any repercussions, along with 'Jeremy Corbyn: discuss' came under their analysis.

The panel: Harriet Lamb, CEO of International Alert; Professor Martin Weale, professor of economics, Kings College London; and



Dr Paola Subacchi, director of international economics research at Chatham House, debated the UK election and the theme of leadership and responsibility within political life. Professor Weale noted the successive blurring of lines between politics and entertainment. Lamb talked about the US and the near-constant stream of accusation and counter-accusation taking place there. Continual

Manchester's convention centre was converted from the city's former rail terminus

waves of controversy underlined the importance of maintaining strong democratic institutions and continuing to politicians to account, she said. The result of failing to counter political lies effectively undermines democracies, but individuals are uncomfortable dealing with hard facts and data, Dr Subacchi pointed out. We carry out more research into household purchases than we do into the political parties we end up voting for, she said.

After a well-received and successful conference, with today's fast-changing business environment and wider context thoroughly debated, delegates made their way home. The ACT's events team, meanwhile, is already looking ahead to welcome members to Liverpool in 2018. ♡

Liz Loxton is editor of *The Treasurer*

# A TRIUMPH OF TRANSFORMATION

How do you successfully oversee a fundamental treasury transformation while still managing the usual day-to-day workload at a time of heightened business activity? Karen Toh provides an insight to her approach in the Grosvenor Group treasury

Words: **Ben Poole** / Photos: **Louise Haywood-Schiefer**



“When I was appointed treasurer in January 2014, it seemed an opportune time to step back and look at the function, what it did and what we wanted it to be,” explains Karen Toh, treasurer at the Grosvenor Group.

The morning on which we are speaking is bathed in sunshine and the clocks have recently sprung forward into British Summer Time, so the theme of transformation could not be more apt. For Toh, transformation in the treasury function was required to support the growing Grosvenor business and the level of treasury complexity that this was creating.

Toh initiated and is responsible for a multi-year treasury-transformation project. “I believed we would be better able to help and support the business through this. There is not an area of treasury that is untouched as part of the transformation,” she says.

Grosvenor Group Ltd is the international urban real estate arm of the Grosvenor Estate. In addition to the holding company, there are a number of operating companies: Grosvenor Britain & Ireland, which includes the London estate; Grosvenor Europe; Grosvenor Asia with a presence in Hong Kong, Japan and mainland China; and Grosvenor Americas, present in the US and Canada. There is also an indirect investment business, where Grosvenor invests in property ventures globally that it does not manage.

In terms of the treasury remit, there is also the wider Grosvenor Estate, the Family Investment Office and the

Wheatsheaf Group (which focuses on investing in food security and agriculture sectors) to think about.

“The GGL ethos is very much that property is managed locally, so you have property professionals that focus on local activity via operating companies around the world. However, for certain specialist functions such as treasury, we try to maintain a coordinated approach, as distinct from a centralised function, across all of the different parts of the business. This is not always as straightforward as it sounds.”

## Five fundamentals

The treasury-transformation project at Grosvenor covers five fundamental workstreams: organisation, governance, systems, processes and controls, and reporting.

The organisation pillar of the project is about developing a new structure and recruiting a new treasury team. “It was important to recruit suitably experienced and qualified individuals who wanted to be part of a significant change journey,” says Toh. “I had to have a rough idea of what the vision of treasury was going to look like in the future to resource accordingly. There is now a new structure and new team in place, and we are currently a team of 12. Treasury is a centre of expertise that supports eight business units. Getting the team in place was a big step forward, and this will continue to be tweaked as needs evolve.”

The governance workstream is an ongoing part of the project that is focused

“The aim was to look at how we could use the available technology to better manage treasury activity”







## VITAL STATISTICS

**8%**

total return

**£12.6bn**

assets under management

**£4.8bn**

shareholder funds

**£136.8m**

profit before tax

**61**

number of cities where  
Grosvenor is active

**1677**

year of origin of the Grosvenor  
property business

**1066**

year in which the history of the  
Grosvenor family can be traced;  
back to the arrival of William the  
Conqueror in England

on better defining the role of treasury in relation to the various operating companies and also in relation to the holding company. New ways of working are being bedded down.

“As part of the work within the governance workstream, there has been a general increase in treasury responsibilities, for example, in regard to the operating companies outside the UK. I would like to think that, as part of this, specialist treasury skills have been increasingly recognised.”

The systems workstream is deliberately being used as a catalyst to improve processes and controls. There is an emphasis on

treasury data, reporting and operational processes. “We wanted to make better use of systems and be more thoughtful about what we wanted to do,” says Toh. “The aim was to look at how we could use the available technology to better manage treasury activity, to be able to build in flexibility for the future, and to cater for how usage might differ across the different businesses while still ensuring that a minimum standard, from a treasury perspective, was in place across the organisation.”

As part of this, SWIFT reporting has been introduced globally to enable daily reporting of bank balances and exposures. There is now an online dealing platform, a deal-confirmation system and market data feeds. Significantly, there is a global treasury management system (TMS) implementation and this is now central to the treasury team’s processes and controls.

“The processes and controls workstream is very much about getting the engine room right – something I believe very strongly in. There are a lot of sexy parts to treasury that I personally love – I am a bit of a deal junkie – but being able to rely on >

## KAREN'S TOP TIPS FOR SUCCESS

1 **Adaptability and persistence are key. Never underestimate the importance of stakeholder management. Because of Grosvenor's devolved structure, we have eight CFOs and their teams as major stakeholders. They are very capable of asking difficult questions.**

2 **I can't do without my tablet. Gadgets don't tend to last that long with me, but the tablet is the exception; it has been used daily for many years.**

3 **I think it is important for treasurers, possibly more so than for other professions, to be able to switch effortlessly between the detail – perhaps identifying risks in a complicated corporate finance structure – to then being able to step back and understand the bigger picture, develop the strategy and articulate the vision.**

4 **The best way to wind down after a stressful day is a quiet meal with my husband or with friends. I love good food and sometimes simple meals are the best. Restorative sleep is important – I was a convert to the benefits of a good night's sleep well before it became trendy!**



the engine room as a sound foundation for other treasury activities is critical.”

Last, but not least, the reporting workstream targets greater reporting integrity, greater efficiency, faster timelines and more insight and analysis. Working closely together with IT, the team quickly understood that there was opportunity to use a data warehouse to manage what can be quite involved reporting.

### Transferable treasury skills

For Toh, there were several attractive reasons to take on the role at Grosvenor, including an increase in accountability, responsibility and the broader perspective that came with this. Perhaps the main pull was the opportunity to apply her corporate finance and treasury skills in a new industry.

“I had valuable experience from my time at Shell and Rio Tinto, and this was a chance for me to apply this in a new context. It was about what was fit for purpose for this specific organisation. This is a different industry, a different size of company, a different structure and culture. For example, Shell's treasury is very centralised, which works very well, whereas this required making something work very well within Grosvenor's devolved structure.”

To be able to seamlessly move between roles in such different organisations, you need to be adaptable and have breadth and depth of experience, and technical knowledge that comes from achieving key professional qualifications, as well as the support and engagement of the treasury community.

“I value the ACT. I was at an ACT dinner earlier this year and I found it was really helpful to discuss and exchange ideas, and to share and learn from mutual experiences. As I sat at the table, with a combination of treasury professionals that I knew and others that I didn't, I found that there were areas that resonated across industries and across perspectives. If you talk about financing, cash management, bank accounts or how we might approach the implications of the latest regulations, for example, it is a useful forum to connect.”

Toh also holds the MCT qualification. “The MCT qualification is something that I believe is a way of differentiating yourself, as there are proportionally fewer treasury

professionals around that hold this more advanced qualification. For me, it was also a way of demonstrating that I was serious about wanting a senior treasury role.”

### Strategic objectives

Grosvenor Group Ltd has three strategic objectives. “The first objective is to deliver attractive long-term returns. Second, we are focused on developing and coordinating an internationally diversified property group. Third, we aim to ensure that Grosvenor's reputation for quality, integrity and social responsibility is upheld.”

Of course, financing is very important for a property company. Depending on specific business needs, the treasury team will develop debt strategy, originate, execute, review and advise on financings. Toh's team executes FX and derivatives for operating companies globally and develop treasury policy minimum standards.

“We now have estate-wide cooperation on treasury exposures, one source of truth for treasury data, a much better understanding of the specifics of treasury

“I was at an ACT dinner and I found it really helpful to discuss and exchange ideas and to share and learn from mutual experiences”



## KAREN'S CV

### 2014-present

Treasurer, Grosvenor Group

### 2013

UK treasurer, Grosvenor Group

### 2010-2012

Manager, corporate finance, Rio Tinto

### 2007-2009

Treasurer, holdings and treasury/  
head of intragroup financing,  
Royal Dutch Shell

### 2006-2007

Head of treasury compliance and risk  
management, Royal Dutch Shell

### 2003-2006

Senior adviser, M&A and financing,  
Royal Dutch Shell

### 2001-2003

Senior fixed-income dealer,  
Royal Dutch Shell

### 1995-2000

Various business analyst, financial  
and management accounting roles,  
Shell Australia and Shell New Zealand



## QUALIFICATIONS

MCT and AMCT (2003-2007),  
Masters in Finance (Distinction),  
London Business School  
(2000-2001),  
Certified Practising Accountant,  
CPA Australia (1996-1997),  
Bachelor of Accounting, Monash  
University, Melbourne (1992-1994)

transactions Grosvenor-wide and a step change improvement in the treasury team's own processes and controls," says Toh. "There is a significant increase in understanding of treasury risks and the need to be joined up in relation to financial institution relationships. Treasury is there to support the businesses and the holding company. There is obviously a more general need to clearly understand what the organisation is specifically seeking to achieve on a project-by-project basis. I very much see us as better being able to support the business in achieving its objectives by fundamentally improving our effectiveness and efficiency."

As the Grosvenor Estate is privately held and trustee governed, there is an overarching stewardship and custodianship mind-set to governance and management that drives the decision-making and thinking at the organisation. "From a practical perspective, we have a considered long-term cautious approach to items such as cash or liquidity management, financing and risk management," says Toh. "Diversification, long-term partnerships with financial institutions based on mutual trust, reputation, being robust in stressed scenarios, being commercially savvy

about pricing and terms, and being fussy about and focused on the details of documentation are all important features."

Perhaps the biggest challenge that Toh and her team has faced is juggling what has been a fundamental change from all aspects of the treasury transformation in addition to managing business as usual at times of heightened levels of activity across the various businesses. But it is a challenge that she and her team have met head-on.

"The transformation has been a marathon, not a sprint. Initially, it was about getting the overall scoping and blueprint right. We were fortunate to obtain strong organisational support and the budget for the transformation," says Toh. "Then it was about planning and implementation. For example, the global TMS rollout required significant time upfront on planning and design, a detailed needs assessment, an extensive request for proposal process and system demonstrations with each of the shortlisted vendors. There was a phased implementation, a dedicated team, regular project executives, steering committees, audit committees and internal audits. There were bumps, some significant, along the way and we navigated through these. The overall TMS implementation has involved more than 110 individuals

globally, across multiple functions and all businesses. Rollout to the GGL Group operating companies has been completed and implementation for the remaining two businesses, part of the wider Grosvenor Estate, is on track. We are overall on scope, on time and on budget.

"As a result of the overall transformation, I genuinely believe that we have created a more robust and resilient function for the benefit of the organisation. Looking forward, there is a lot more to do in the short and medium term, but I am proud about what has been accomplished so far. Building on the foundation that has been put in place, I see us becoming an even more agile and adaptable treasury function going forward." ♥

Ben Poole is a freelance writer and editor, specialising in treasury and transaction banking

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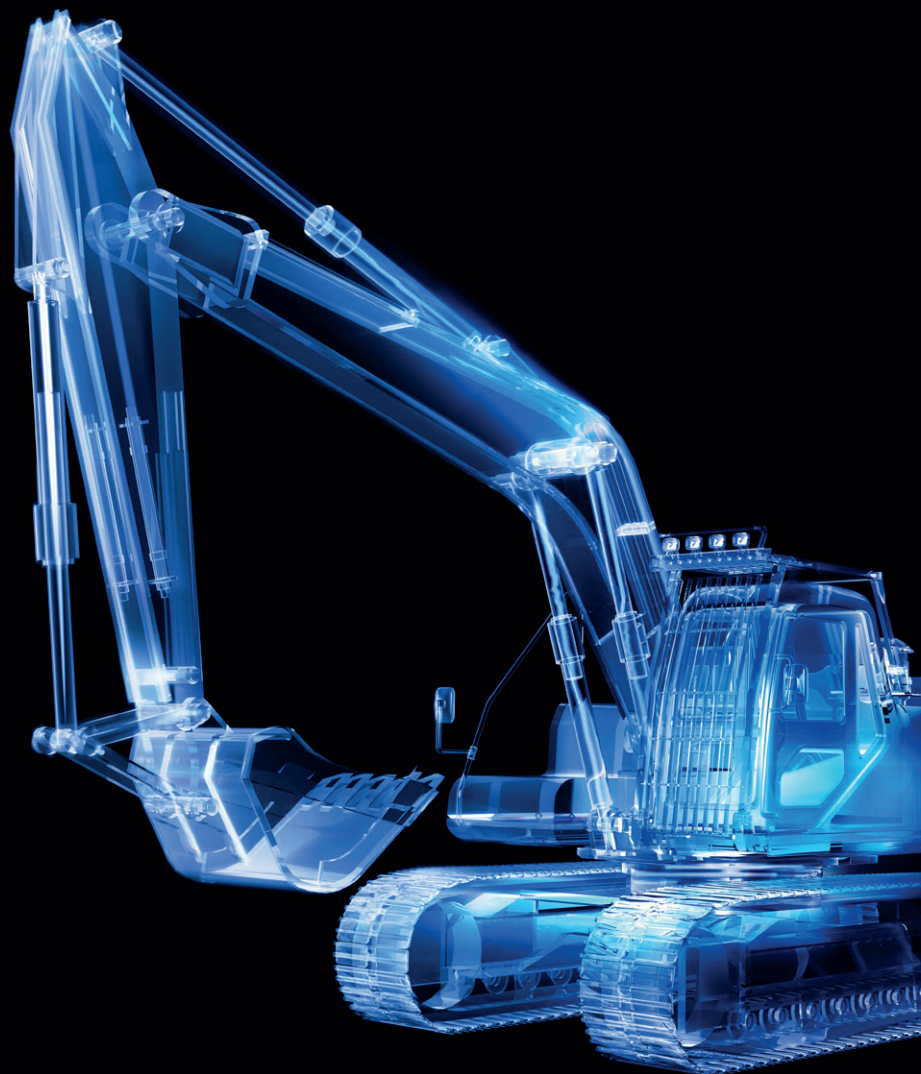
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SPECIAL

# CASH & LIQUIDITY MANAGEMENT



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**Cash and liquidity in the boardroom**



# A CLEAR LINE OF SIGHT

Being able to accurately forecast cash in both the near and long term requires accurate data and successful integration of systems, people and business processes. However, a 2016 treasury report from Ovum and Temenos found the lack of real-time data availability was a significant operational issue for more than a third (35%) of all corporates surveyed.

## ON THE DAY

With multiple bank accounts across different countries and currencies, the quest for visibility over cash is one of the treasurer's key challenges. A critical cash forecast that many companies work from is the immediate on-the-day forecast. It is common to run several of these with different cut-off times by currency, so GBP comes before USD, for example. The insights of an immediate cash forecast are vital to managing on-the-day cash.

"Our on-the-day forecast is updated a number of times during the day," says Frances Hinden, vice president treasury operations at Shell International. "It is partly automated, partly manual, and we are on the journey of automating that further. We will never get fully there because there are always items that come up that do not make it into the ERP in time to make it into the forecast, although people may know that something is coming at the last minute."

Attaining strong cash visibility in complex business is the ambition of many treasurers. Ben Poole asks three how they approach it


At Shell, there is also a statistical model that sits on top of the immediate forecast for some of the receivables, which uses treasury knowledge of who tends to pay late and who tends to pay early. This extends out up to 20 days. "It becomes less accurate as you go further out very quickly, as all automated cash forecasts do," says Hinden. "We put in the big flows manually if we know they are coming, particularly the major treasury flows, such as internal and external dividend payments and big tax payments. It is the nature of our business that we have some very large payments, such as taxes and royalties, while individual cargoes of crude oil can also be big payments in and out. When we know of these things, we put them in the forecast. The forecast is linked automatically into our TMS."

Just knowing where your cash is for immediate needs can be straightforward. Corporate treasurers can get the visibility of all bank balances across their cash management banks in near-real time using standard SWIFT messages and MT 940s, for example.

"In many cases, balance reporting and reconciliation can be fairly well automated

using SWIFT capabilities," says Valeriy Zubkov, a treasurer with direct forecasting experience at a FTSE 100 corporate. "It is more difficult for those corporates that are using a variety of proprietary online banking platforms. Further complexity may arise where corporates operate a number of different ERPs and you try to consolidate the data in different formats from different systems."

The importance of an on-the-day cash-flow forecast will usually depend upon the size of a company's cash and the amount of liquidity it needs. "At the end of last year, we had \$19.1bn of cash on our balance sheet and, as we manage nearly all of this centrally, an end-of-day cash forecast is very important to us, because we do not wish to leave this much on bank accounts," says Hinden. "The scale of our cash gives us concerns about counterparty credit risk as well as optimising yield – we don't leave large sums with our banks overnight because there is a credit risk. We like to have as much of our cash as possible either with highly rated banks or AAA money market funds, or where possible, collateralised via tri-party repos. Some companies with a smaller cash balance may not be >



so worried about that credit risk, but if a bank goes bust and you lose your money, it doesn't matter what the size of your deposit is. If that was your liquidity, then you have lost it."

### LONG-TERM FORECASTING

When it comes to longer-term cash-flow forecasting, information may not be as easily sourced from the internal accounting systems as it is for short-term forecasting. An operating cash-flow forecast relies on the effectiveness of a sales and operations planning cycle, as well as the maturity of internal financial planning and reporting systems within the corporate. To achieve high forecasting accuracy, treasury needs to work closely with business managers from various departments, such as sales, distribution, supply chain and tax. Treasury also needs a seat at the table in the key operational forums to be able to capture business issues that have potential cash-flow implications.

The operating cash-flow forecast is then over-layered with the financing flows from the treasury management system (TMS), which are fairly certain. If you have maturing deposits with banks, for example, you will know exactly when these flows are expected to occur.

"In a previous treasury role, I worked on a project to implement a system to aid the accuracy of our cash-flow forecasting, particularly in the medium-to longer-term range," explains Zubkov. "The project was aiming to improve the visibility of cash flows within the organisation and provide a reliable forecast, which is a fundamental input into all treasury decisions on liquidity, funding and FX risk management. This was a global project – every business unit was required to provide monthly rolling, 24-month multi-currency forecasts of their cash flows from customer collections to supplier payments, salaries and tax, as well as financing flows and

dividends. The collection and consolidation of forecasts were enabled by the web-based platform, which was subsequently integrated into the treasury end-to-end IT ecosystem. The flexible and easily scalable system is available to users globally and allows reporting and analysis across multiple geographical hierarchies, currencies and flow types."

In Zubkov's example, the system outputs are aligned with the company's hedging policy, meaning that treasury knew exactly which flows to hedge, when to hedge and in which currency.

At Shell, there is a group process to look at current quarter and current year profit and loss (P&L), cash-flow forecasts, and upcoming year P&L and cash-flow planning. "We put a treasury view on that in terms of what we know about investment, divestment and revenue phasing, what we know about financing cash flows, such as bond repayments, external dividend payments and debt service, to produce a month-by-month outlook up to the end of the following year," explains Hinden. "This is used for longer-term decisions on our financing strategy, such as debt issuance."

A treasury's knowledge of trends in big cash flows is essential to a successful long-term forecast. However, some areas are unpredictable. For example, the European Market Infrastructure Regulation reporting has imposed mandatory variation margining on companies with total transactions over a certain value. Shell is one such company. "All of our derivatives trades are now margined and we will also



be hit by initial margin soon. I know some corporates choose to margin all their trades to reduce the potential credit charge and get better pricing," says Hinden, "but this is a liquidity drain that is unforecastable. If interest rates or exchange rates move, then we may have margin calls. Currently, this isn't a big number because we have only just started margining, but the potential number will grow over the coming years."

### ORGANISATIONAL BUY-IN

To get the most accurate information possible, it is critical that business units understand the integral role that their reporting plays in the process. With the project that Zubkov worked on, a lot of attention was focused on educating the business managers in the methodology and benefits of the process for the wider organisation.

"There was a big focus from treasury to engage all of the local corporate finance managers through a number of regional workshops, to make sure that they understand how the system and process are intended to work and, importantly, how their reports are used to manage the group's treasury risks," says Zubkov. "The project team also developed a detailed forecasting guide for business managers, and launched an online training course available on-demand through the company intranet. Feedback on their forecasting accuracy is regularly provided to business units so that learnings can be analysed and applied in the next forecasting cycle."

Since the implementation of a new process and consolidation platform, the quality of cash-flow forecast improved significantly, with a large number of business units consistently reaching over 90% accuracy. This was achieved, to a large degree, due to support from senior finance management across the organisation. "The drive from treasury and support from senior stakeholders from CFO down to the local FD really helped increase the accuracy across the company," says Zubkov.

It is important to consider that local finance managers can be conservative

**The importance of an on-the-day cash-flow forecast will usually depend upon the size of a company's cash and the amount of liquidity it needs**





## If interest rates or exchange rates move, then we may have margin calls

when forecasting cash. This is not helpful for the treasurer. “You cannot just think that because they are always conservative that you can add 10% per month, for example,” says Paul Stheeman, an independent treasury consultant and interim treasurer. “Some finance managers can hide behind things such as budgets and approved expenses, but they don’t really like to use their gut feeling. I push them to use this, as they know the business. If the controller of a business unit knows that there will be a contract signed in two months with payment terms for three months after that, put this in the forecast for five months’ time. Don’t leave it out because it hasn’t been officially budgeted or forecasted yet. You need the full picture to have the most accurate cash forecast. Getting people out of their comfort zone to do this can be a challenge.”

### WHEN NOT TO FORECAST

“One of the things that we generally don’t do a lot of is what you might call medium-term forecasting,” says Hinden. “Historically, we did a month-end forecast, but we don’t do that any more. We discovered two things from doing medium-term forecasting. The first is that we rarely made any decisions on the basis of it. The second was that, although much of our business was entirely capable of doing an accurate month-end forecast, our trading business could not forecast cash requirements beyond a day or so because they depend so heavily on the oil price and other commodity price movements.”

Companies that are subject to cash margining are likely to maintain larger chunks of short-term liquidity due to large movements in margin



calls. This does beg the question as to what the point is of doing an accurate forecast for 95% of the business if 5% of the business is then going to radically alter the actual outcome.

In another scenario, what should you do if your company has a number of bank accounts in different parts of the world that do not sweep to the centre because they are constrained by country-specific regulatory requirements? This is a question that Shell is tackling at the moment.

“We have quite a lot of accounts, particularly local currency accounts, that don’t sweep,” explains Hinden. “We do cash forecasts for them, but some of them have very little movement – our forecasting will be 100% accurate, but how useful is that? We may be wasting manpower doing a perfectly accurate forecast when it actually doesn’t matter. So, we are doing a piece of work to look at where we can stop forecasting, and to see if we can use robotics to improve some of the automation to pull data out of systems. We are moving to more automation on everything that is centrally managed and centrally linked to our main ERPs, but we also do cash-flow forecasting for some of our joint ventures. This can be more manual, so what do we need and what can we provide to our joint ventures?”

**Ben Poole** is a freelance journalist specialising in treasury and transaction banking

## FORECASTING CASH

**PAUL STHEEMAN HAS BEEN AN INTERIM TREASURER FOR SEVERAL YEARS, MAINLY IN THE PRIVATE-EQUITY WORLD WHERE CASH FORECASTING IS AN IMPORTANT KPI THAT PRIVATE INVESTORS LOOK AT. HERE, HE EXPLAINS HIS TOP TIPS:**

- Generally, what I am looking for is quite similar from company to company. I have seen companies that have some kind of cash-flow forecasting, and there have been others where there has been nothing in place at all. The approach I take is similar in both cases.
- I look to engage the local finance managers or those responsible at the subsidiary level as early as possible, as they are the ones that are going to be providing the information for the group treasury function. Most private-equity-owned companies that I have worked for are required to produce a short-term 13-week forecast in the first place. Most investors are looking to receive this



forecast as soon as possible and as accurately as possible. Quite often, these two do not usually go hand in hand.

- Preparing a relatively simple Excel spreadsheet for forecasting is a good first step. It makes sense in many cases to move away from Excel to a dedicated forecasting system, but there may not be time to do so immediately.
- It is important to engage the local management immediately, but also continuously. Provide regular feedback to those providing the reports. Ask them questions if there is something that does not appear to be clear or understandable at first sight. This can happen quite often.

Strong customer authentication in the corporate sector is becoming more important by the day. Jonathan Williams looks at the technological state of play

# WHO GOES THERE?

Fifty years ago, before the advent of always-connected banking, staff in branches would be able to recognise and authenticate customers and their signatures. Knowing your customers was something bank employees were required to do. Today, with the rapid move away from physical branches to electronic communications, e-banking and mobile apps, authentication has also had to keep pace. As we start to move to fully electronic transactions, including FX, payments, finance and trade, the method by which we prove who we are is being strengthened, both as consumers and employees.

These days, we have less direct, physical interaction with bank staff

than ever, proving that you are indeed an authorised person requesting bank services is essential. Treasury staff will be familiar with the drawer full of security tokens, each issued by a different bank, sometimes for a subset of accounts, by which the electronic banking system is secured. This is the fifth generation of customer authentication and goes hand in hand with improved KYC and anti-money-laundering requirements placed on the banking industry.

The key driver behind this is the evolving nature of crime. Today, most financial crime is electronic, with the criminals located perhaps in a different country from the bank. Defrauding

businesses and consumers by misusing weak security measures has become the norm and initiatives such as secure, chip-based, payment cards have now rolled out worldwide, with the US one of the last adopters.

In addition, there is a goal to increase competition in the services used by treasury and consumer. Fintechs are looking to leverage bank data and services to provide improved, end-to-end solutions across banks that can solve problems for a subset of the client base. Better supply chain finance, integrated directly with payables and enterprise resource planning systems, is one such example. The name for this initiative is Open Banking and is encoded in the EU's second payment services directive (PSD2), but the *quid pro quo* is adoption of strong customer authentication, so banks can be sure it is their customer transacting.

What PSD2 says is that the payment service user must be authenticated by their payment service provider under three situations:

- initiation of an electronic payment (in person or remotely);
- logging into a remote account management service (such as online banking); and
- any action conducted remotely where there is a risk of fraud or misuse.

These three cover pretty much every case in which corporates use banking services, from change of mandates to e-banking, download of statements and, of course, issuance of credentials. It's likely that businesses will see authentication pop up more frequently in their engagements with the bank, including over the telephone. PSD2 also states that some part of the authentication should be dynamic, ie not relying on static data, such as a password, but transaction- or time-based one-time codes or response to security challenges. In the UK, we are familiar with the last method in the context of PINsentry devices, which generate an eight-digit code based on online banking transaction information. These will become more prevalent.

Banks are looking to minimise the impact on the customer experience

## GENERATIONS OF CUSTOMER-BANK AUTHENTICATION

Generation	Type	Techniques	Location	Technology
<b>First</b> (to 1980)	Knowledge Inherence	Personal recognition	In branch, telephone or by post	• Human recognition of person, name and signature
<b>Second</b> (1960-2005)	Knowledge Possession	Bank-issued stationery and devices	In branch or by post	• Human recognition of document, card and signature
<b>Third</b> (1985-)	Knowledge	Username and passphrase	Internet and e-banking	• Secure passwords/ phrases
<b>Fourth</b> (1995-)	Knowledge Possession	Username, passphrase and second factor	Telephone, internet and e-banking	• Bank-specific security tokens, eg smartcards • User-specific data, eg financial info
<b>Fifth</b>	Knowledge Possession Inherence	Flexible, risk-based multi-factor	All channels	• Broad range of techniques, mostly electronic



## THE THREE TYPES OF AUTHENTICATION

- **KNOWLEDGE** – something that you know: a shared secret or set of personal information.
- **POSSESSION** – something that you have: a secure token, key or device.
- **INHERENCE** – something that you are: a physical measurement or behavioural model of an aspect of you: a fingerprint or an analysis of your gait.

Some of these are static, such as passwords, and some dynamic, such as facial images. Use of more than one of these types of authentication method improves confidence that the individual is the same one who registered, but in most cases not directly their identity. Some of these give a weak correlation with identity, such as location, and others are much stronger, such as one-time cryptographic codes.

and some authentication could be done transparently, for example, voice recognition on telephone banking and device recognition of your usual laptop when using online banking. It is certain, however, that there will be some change, and corporates should prepare to adopt these new technologies as they roll out over the next 18 months.

So, what are the implications for treasury? First, in the EU, it is likely that your bank may want to introduce new methods of proving who you are as an employee of their client. This is likely to mean that new security tokens may be issued and you may be asked to register your voice so the bank can be sure it's you when you call them. This will apply to anyone who deals with your bank, in many cases not just treasury staff, but those in payments factories and senior management in group companies.

Second, authentication is likely to become more personal. While you can share a security token with a colleague, even if against bank advice, it is much more difficult to share a biometric. Banks will correlate use of tokens with biometrics, so don't get them mixed up between users, as if you do, you could get temporarily locked out.

Third, some banks are trialling mobile-based authentication, such as fingerprint, voice or 'selfie'. While your work phone may be capable of handling these needs, many users will choose to use their own phones for convenience. This opens up the potential that a significant payment from a company may be authorised on a device that isn't owned by it and may not have appropriate security measures. Already there are cases of apps available from the Google Play Store that have malware hidden inside and are targeted to compromise bank apps, such as authentication and mobile banking.

Fourth, each bank will select its own technology and techniques for authentication, which may cause confusion and add to the requirements on internal IT security. This may mean that systems that access the bank, but can be managed centrally, such as a payments gateway, may become preferable in terms of cost of ownership.

Lastly, under the EU's forthcoming General Data Protection Regulation, which becomes enforceable on 25 May 2018, biometric data must be treated as sensitive personal information, so storing this on a bank server or a work mobile for business purposes, such as

There is a goal to increase competition in the services used by treasury and consumer

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bank authentication, will bring it into the scope of corporate compliance.

## THE FUTURE

The political goal of opening up the customer-to-bank interface for all customers, corporate and consumer, is common across Europe and is starting to gain traction in North America. To secure these new, electronic portals to the bank, security must be improved to protect customers' accounts and assets from financial crime. While authentication has moved forward, criminals have moved quickly, too, and corporates risk being at the tail end of the initiative to reinforce banking infrastructures. Corporates would be best advised to embrace the change as soon as possible. 📌



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With a delicious sense of irony, change is one of the few constants in life. As the dramatic events of 2016 have revealed, even the most established of global norms are subject to change, fuelled by the relentless march of technology and the ongoing impact of the economic crash.

One of the main responses of the authorities to the crash was a complete overhaul of bank regulation both in content and in style. Banks today hold almost an order of magnitude more equity capital than they did in the summer of 2007.

They have also been subject to large fines for historic misconduct and are now subject to far greater regulatory oversight, increased reporting requirements and increased personal liability for senior management.

Consequently, fewer bright graduates now put a career in finance at the top of their 'employer of choice' list compared with pre-2007/8. Google is now more prestigious than Goldman.

But, despite significant shifts, some aspects of regulatory changes have yet to be realised. While the pace of new regulatory initiatives is now slowing, the significant time taken to implement many of these means that much of the impact on bank behaviour (and, ultimately, the end customer) has still to manifest.

Over the next few years, the full force of these changes will be felt, as several key pieces of legislation come into effect.

#### MiFID 2

The first initiative to have an impact on European banks comes into force on 3 January 2018.

Known as the Markets in Financial Instruments Directive II (MiFID II), and the accompanying Regulation (MiFIR), its main objective is an increase in investor protection.

For corporate treasurers, the most immediate consequence of this will be the greater transparency provided by banks on pre- and post-trade execution. Less important will be the creation of new regulated trading platforms (organised trading facility) to capture more activity that is traded on unregulated platforms.

But, as investment firms continue to analyse the implications of regulation on

their business models, strategic decisions will need to be made. Some of the lower-tier investment firms are likely to continue to reduce their service offering as the limited sales volumes for certain products no longer justify the increased compliance cost.

It is likely that one of the unforeseen consequences of this new legislation will actually be a greater concentration of activity in the very largest trading banks.

This may have implications for which bank counterparties are available for a particular financial instrument – something for corporate treasurers to monitor.

#### IFRS 9

Just two days earlier, IFRS 9 comes into effect within Europe.

While IFRS 9 covers a number of areas, it is the new standard for loan provisioning that will have the biggest impact on banks and may impact their future appetite for certain types of credit.

Compared with existing loan provisioning, IFRS 9 is forward-looking in nature and brings in the concept of expected credit loss. The day a loan is originated, the bank will now have to book a loan provision for one year's expected credit loss.



# BRAVE NEW WORLD

Ian Tyler charts the changing nature of banks as they evolve under successive rounds of regulation and sets out the impact on treasurers

Given that the loan will earn income on an accrual-accounted basis, the bank is, in effect, booking a loss on day one. If there is any subsequent significant credit deterioration for that loan, then the provisioning moves to stage two and is converted to a lifetime of expected credit loss.

To forecast provisions, a macroeconomic forecast is required – one that the new legislation insists should be unbiased and probability weighted. But, given the imprecise nature of economic forecasting, we can expect, without any inherent bias, that a selection of banks will have a distribution for their central forecasts for the economies in which banks operate.

There is clearly a range of reasonable values for such important economic numbers as unemployment or GDP. When including the potential for subtle (or unsubtle) forms of bias to manifest in the economic forecasting process, then the dispersion of economic forecasts will increase further.

For many banks, it will be the combination of IFRS 9 and stress testing that effectively becomes their binding capital constraint. Banks will look to manage this constraint, and one of the most obvious ways to do so, is to reduce the term commitment of loans.

## RING-FENCING

Looking ahead to January 2019, major UK banks are meant to have implemented ring-fencing. This will mean their core retail banking activities will have to be in a ring-fenced bank (RFB) and certain excluded activities, such as trading of derivatives, must be in a non-ring-fenced bank (NRFB).

For treasurers, the main impact that they will need to consider is that the new NRFBs are likely to have a lower credit rating than the current bank. This will mean that they need to look at their counterparty credit risk policies, including their attitude to giving and receiving collateral.

What will be particularly interesting is whether the rating agencies give the respective NRFBs, as well as the RFBs, some credit for the large volumes of structurally subordinated bail-inable senior debt that is now being issued out of the banks' holding companies to meet

For treasurers, the main impact that they will need to consider is that the new NRFBs are likely to have a lower credit rating than the current bank

the forthcoming total loss-absorbing capacity/minimum requirement for own funds and eligible liabilities requirements.

While probability of default might be higher for an NRFB than its sister RFB, the loss given default may actually be lower, as insured retail deposits in the RFB are now structurally senior to other senior exposures.

A banking group can still approve one overall credit limit for a corporate counterparty and then allocate that limit within the group across the various RFBs and NRFBs. One overall relationship manager is still allowed in theory, but there will be some constraints on what they can and cannot do.

For the banks that have chosen to put much of their corporate activity in the RFB, one other aspect that the regulators will monitor closely is whether the RFB is in effect subsidising the NRFB's selling of ancillary services by the provision of 'cheap' revolving credit facilities.

## BASEL IV

Formally, there is no such thing as Basel IV, as regulators insist that the various proposals are just further enhancements to Basel III, but it remains a useful shorthand for proposals still coming down the pipeline.

The main proposals relate to change to the use of Advanced Internal Ratings Based (A-IRB) credit models, the fundamental problem with which is that implementation has not been consistent across jurisdictions. The same credit can receive very different risk weightings.

The Department for Business, Innovation and Skills (BIS) has proposed four solutions to reduce this variability:

- 1) Remove the option to use the IRB approach for certain exposures;
- 2) Impose new model parameter floors to ensure minimum level of conservatism;
- 3) Provide greater specification of estimation parameters; and
- 4) Implement an output floor against Standardised.

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The current proposals would mean that the largest corporates (with total assets exceeding €50bn) would be forcibly moved out of A-IRB and onto Standardised.

For corporates with asset bases below €50bn, there is a split between those with a revenue of above €200m per annum and those with a revenue below. Those below can stay on A-IRB, whereas those above would be forced onto foundation IRB.

This would mean that the largest corporate risk-weighted assets weighting would revert to 100%, which is actually higher than the 75% standardised weight used for claims on small business – hardly risk sensitive. It will certainly reduce banks' return on regulatory equity for large corporate exposures, so may in turn reduce banks' appetite to hold significant exposures to such firms.

Perhaps, unsurprisingly, the jurisdictions that have implemented the A-IRB models with the lowest weightings are the least keen on BIS's proposals and, at present, their opposition is delaying finalisation of their approval. Watch this space to see how these play out over time.

## THE ROAD AHEAD

On a stand-alone basis, many of the changes coming into effect are sensible – and banks have undoubtedly had enough time to prepare for them.

What remains to be seen is how the combined effect on bank behaviour will play out. The rational response of both providers of capital and customers may be to migrate additional financial services activity out of the banking sector. It looks like the shadow-banking sector is set to grow further. ♥



**Ian Tyler** is a managing director at Alvarez & Marsal, and heads up the firm's treasury advisory practice in Europe



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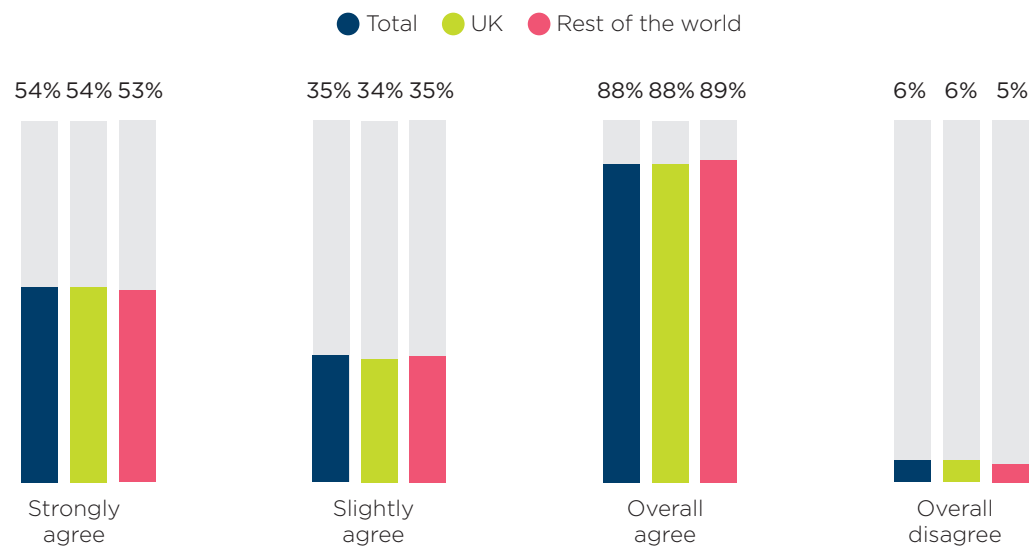
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# CASH CALL

When boards request information on cash and liquidity, it's time to sit up and take note. David Tilston outlines situations that might prompt them

Boards of directors do not routinely scrutinise cash and liquidity resources, in my experience. Their interest in this matter tends to be triggered by specific circumstances that cause them to concentrate on cash issues at short notice and in much greater detail than the norm.

Directors' attitudes will depend where on the spectrum the organisation lies between a) the well-capitalised listed group with easy access to funds; and b) the cash-strapped entity struggling to survive.

Their perspective on liquidity and the accuracy of cash forecasts will contrast enormously. I take an illustrative look below at these two extremes, and then also cover some of the circumstances that can lead to raised scrutiny of cash availability and forecasts.

## THE WELL-CAPITALISED LISTED GROUP

For large listed groups with easy access to funds via the equity and debt-capital markets, possibly backed up with a strong credit rating, the level of cash balances held within the business will rarely be a matter for board discussion.

In the UK, as a result of corporate governance arrangements, cash projections will commonly be reviewed in connection with the viability statement included in the group's annual report. The board, in this forward-looking statement, will normally conclude that it has a reasonable expectation that the organisation will continue to meet its liabilities as they fall due. This will be couched in respect of a specified time period, and

a three- to five-year horizon is quite common. The board will review the organisation's principle risks (plus mitigating actions available) and will consider the multi-year output of financial models projecting the likely impact of various scenarios. Ensuring the organisation remains solvent with sufficient liquidity and complies with its financial covenants will be a key focus. The directors will refer to this analysis in the annual report to explain the approach taken in reaching their conclusion.

As part of the year-end audit process, the audit committee may also occasionally examine other cash-related matters, for example, whether the organisation has any trapped cash in specific jurisdictions that is not immediately available for deployment elsewhere in the group.

## THE CASH-STRAPPED ENTITY

Here, the board's focus will be entirely different.

There may be a real concern that the business might run out of cash and be unable to pay its liabilities as they fall due. Individual directors may be concerned about their potential personal liabilities if they are found to have continued trading unlawfully. If the organisation has borrowings, directors may run the risk of breaching financial covenants or other obligations, which could give the lenders the ability to

require immediate repayment of their debts, or to enforce security over any pledged assets.

In such circumstances, there will be a very close focus on conserving cash reserves, possibly even at the expense of profitability. It may be necessary to report cash balances to the board on a daily basis, and forward cash forecasts will be critically important.

Indeed, in some circumstances, these forecasts might also be essential to the organisation's eventual survival. If the lenders can get comfort that the cash forecasts (typically extending out 13 weeks at least) are reliable, and these do not show a significant deterioration, then the search for an appropriate solution to the challenges faced may proceed on an orderly basis. If the lenders feel they cannot rely on such forecasts, or that these show a significant short-term deterioration, then this may precipitate an immediate response from them to protect their position.

Note that the 'cash-strapped' scenario does not necessarily imply that the organisation needs to be in distress. It could be a function of entrepreneurial or private-equity-backed owners wanting to minimise their cash commitments to a particular investment as they decide how best to allocate their resources across a portfolio of interests. If they can keep surplus funds in one business to a minimum, that may enable them to take advantage of other investment opportunities elsewhere.

## SOME TRIGGERS

While the board may be relaxed about its cash and liquidity position, there are

It may be necessary to report cash balances to the board on a daily basis, and forward cash forecasts will be critically important



## TREASURERS' QUESTIONS

- What issues are the board most concerned about currently, which are relevant to the organisation's cash resources?
- Are there any changes afoot that could cause the board to require a greater focus on cash and liquidity?
- Can the treasurer communicate the relevant risks and opportunities in simple way for the board to grasp so they can make an informed decision?

some situations that will undoubtedly trigger increased scrutiny. The following are some examples, but note that this list is not exhaustive:

1. **A significant deterioration in trading** – possibly due to emerging competition or a change in customer behaviour impacting sales, which leads to increased volatility and an increased risk that the organisation will not achieve its financial (and cash) forecasts, with a knock-on impact in the confidence of its shareholders and lenders.
2. **An acquisition opportunity or a major capital investment** – the board may be presented with an investment opportunity that it may need to fund by a combination of equity and debt. It will be quite normal to try to minimise the amount raised, where sensible, by utilising existing funds in order to minimise unnecessary costs and fees.
3. **Disruption to the financial markets** – where the ability to issue equity or raise debt becomes temporarily more difficult due to a lack of investor or lender appetite due to some unforeseen event (for example, the Brexit vote). In this kind of situation, the ability to deploy funds more effectively, or to agree to a lower level of undrawn facilities, to defer or avoid any refinancing activity, will be on the table.
4. **Activist shareholder activity** – where a vocal shareholder argues that the company is being



inefficient in the way it utilises its financial resources, which could lead to unplanned shareholder distributions and a gearing up of the balance sheet to reduce the company's weighted average cost of capital.

### ADVICE POINTS

It is very difficult to predict when directors will want to assess the group's liquidity arrangements in greater detail. Indeed, the level of scrutiny will be partly driven by where the organisation lies on the spectrum between a) having easy access to funds in all circumstances; and b) being severely cash constrained.

Regardless of what prompts the closer scrutiny, there are questions all treasurers should ask themselves (see box, above left). I cannot, however,

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stress enough the importance of finding the right way to communicate what may be a complex range of outcomes to directors in a way they can easily understand, and which allows them to take the most appropriate decision. Simplicity and a big-picture approach, rather than a barrage of detail, is likely to be appreciated by most boards. ♥



**David Tilston** has been CFO of a number of companies, both listed and private-equity backed

# CASH & LIQUIDITY MANAGEMENT





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# MEASURE AND

IN THE FINAL PART OF A SERIES OF THREE ARTICLES, BEN WALTERS SETS OUT A FRAMEWORK FOR EMBEDDING VALUE CREATION

# INCENTIVISE

Corporate finance is most relevant to firms in two areas: first, project and investment appraisal, the familiar 'static' discounted cash flow; and second, balance-sheet management – targeting a desired debt-to-equity ratio in order to minimise weighted average cost of capital (WACC) under the trade-off theory.

But wouldn't it be great if a third item could be added to the list, that of management performance measurement and reward? We all know the old adage: you get what you measure and reward.

If we could directly measure value creation, then this is what we would get. However, the value drivers in corporate finance are risk and future cash – both notoriously difficult to measure.

Well, read on... the rest of this article explains how this can be easily achieved within the existing reporting framework of every firm.

## State of play

Performance measurement and reward are currently centred on profit and loss (P&L) reporting. While the sophistication in terms of measurement may have moved on slightly over the course of many years, they remain firmly book based, reflecting historic cost and accruals-based accounting and reporting. There are, of course, techniques out there, such as economic value added (EVA), that attempt to

take reported book numbers and adjust these to derive a value-created metric for a period. However, there are disadvantages. EVA, for instance, can involve a large number of adjustments, sometimes arbitrary in nature, risking miring management and finance teams in a sea of adjustments. Taken to the extreme, more complex incentive arrangements, such as phantom share options schemes, for example, can literally paralyse an organisation.

So, does the firm leave it to the equity markets to decide if value has been created or not? Clearly, metrics such as improving profits, revenue and cash flows are all indicators of value creation, but what are the risks being undertaken to achieve these, how much capital has been deployed to deliver these, and how does this performance compare to the market's assessment

of the value the firm *should be* creating from its strategic position? To answer this, in article one, I introduced the concept of MWACC\* – or market-weighted average cost of capital.

MWACC is the hurdle rate a firm must achieve on its investments in order to justify its current value. However, to take things to the next level, that of creating a process against which management can be measured and rewarded, a little manipulation of the reported data is required. The key principles to get to this stage are to:

- accept the principal of working with incremental results; and
- understand the investment horizon of the business.

## Incremental results

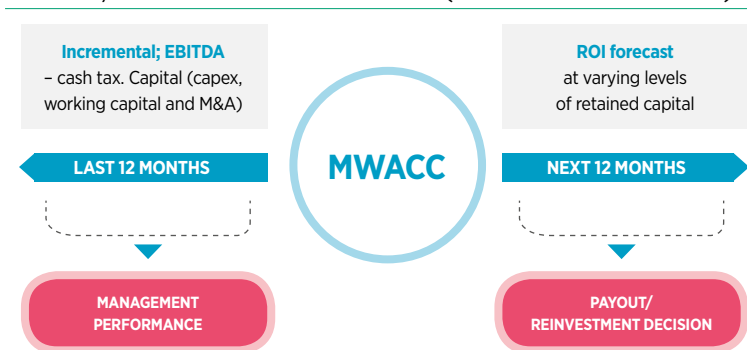
To take out a lot of the noise around reported numbers and focus on the direct effect management

decisions have had on the business, only incremental results count. Current levels of profit and cash flow made from past investment decisions are 'sunk' items in corporate finance parlance. For many firms, a substantial element of their value comes from the market's assessment of its future, not its past. And, of course, if you want to measure and reward performance over a period, you measure what has changed over the period. Other advantages of thinking in terms of incremental changes are that the effects of inflation haven't taken hold and the distortions of accruals-based accounting adjustments, such as depreciation, amortisation and impairment, are minimal.

The effect of working in incremental results is that you are only focusing on what management is directly responsible for over the period being measured, without distortion from inflationary effects and accounting practices. In addition, it is incredibly straightforward; few, if any, adjustments are required to the reported numbers.

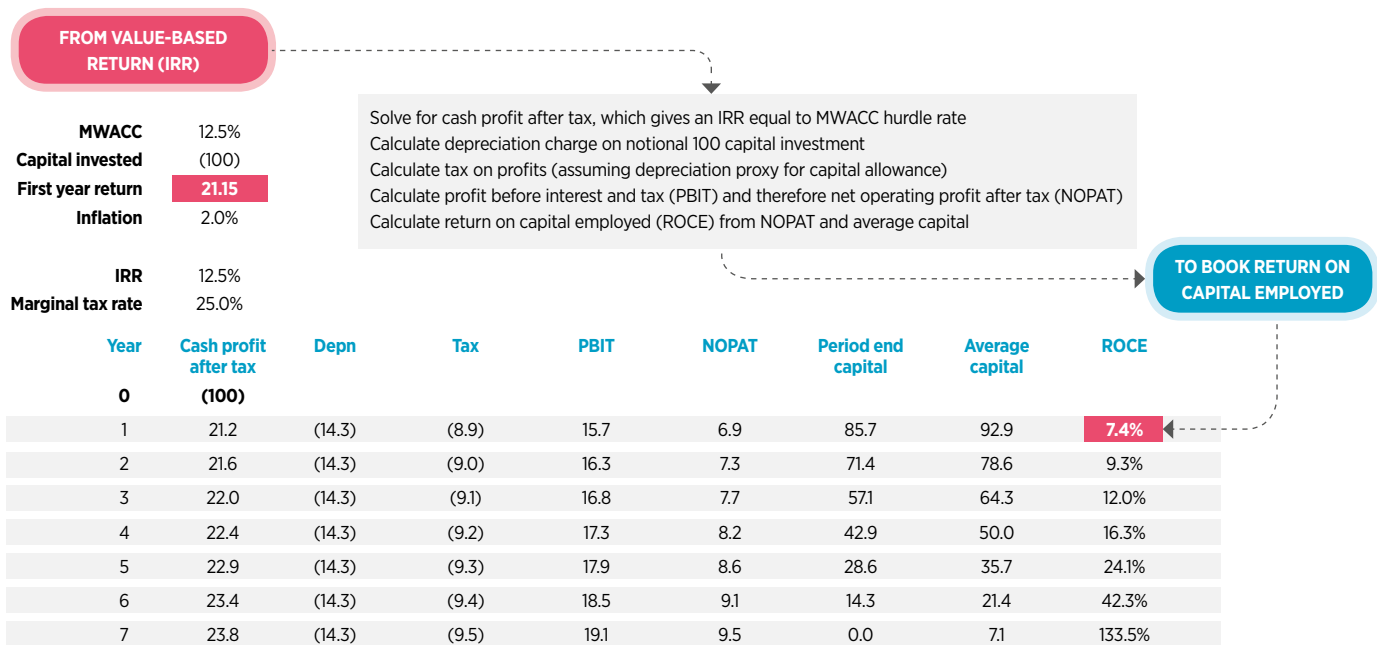
But what precisely should you be measuring? There is an inescapable fact that one of the fundamental assumptions we are taught about corporate finance, that of there being no restraints on capital, is actually not the case at all in the real world. Firms tend to generate their own capital or borrow it. In this capital-constrained world, the hurdle rate for the internal investment decision is always different from the rate of return external investors required, as long as these investors perceive some kind of strategic value in the firm. This is the MWACC hurdle rate, the return required when the firm invests capital internally or acquires new businesses. The firm should measure the incremental return against MWACC. Figure 1

FIGURE 1: MWACC SHOULD BE USED TO DETERMINE MANAGEMENT PERFORMANCE (LOOKING BACK) AND THE PAYOUT/REINVESTMENT DECISION (LOOKING FORWARDS)





**FIGURE 2:** SHOWS THAT THE INCREMENTAL ROCE OF THIS FIRM, IE THE CHANGE IN NET OPERATING PROFIT AFTER TAX OVER THE CAPITAL INVESTED IN THE YEAR, SHOULD BE AT LEAST 7.4% FOR MANAGEMENT TO HAVE CREATED SUFFICIENT VALUE IN THE PERIOD FROM THE INVESTMENT DECISIONS IT HAS MADE



From value-based target (IRR) to book-based target; incremental (first year) ROCE

(left) illustrates the two ways in which the firm should be using MWACC: prospectively for its payout decision and retrospectively for measuring management performance.

**Linking book numbers to value**

A very common and widely understood book-based performance target, such as return on capital employed (ROCE) can be easily derived from a value-based measure, such as internal rate of return (IRR). An IRR equal to the true hurdle rate, MWACC can be converted using simple maths into a target incremental ROCE result. Figure 2 (above) shows how to perform this magic trick. The first step is to back-solve the amount of cash profit after tax (effectively EBITDA less cash tax) that generates the IRR

equal to MWACC. This cash profit number can be worked through to provide a reported ROCE target. Hey presto, you now have a book-based target, universally understood and reported upon, that is truly aligned to increasing the value of the firm.

**Target setting**

The beauty of being able to translate value creation into a book-based key performance indicator (KPI) is that you have on offer a range of KPIs and can select those most appropriate to your business. For instance, you could use the following targets: revenue, profit before interest and tax (PBIT), margin, cash conversion or capital allocation. I am sure readers can think of many others, but the point is you have a starting

point based on value creation, and the KPIs flow from this. P&L-based KPIs set from a foundation of value creation have true purpose.

Yes, it is true that these KPIs will change as MWACC changes (it is partially a market-based measure). Investors will be sending the firm's management messages about the amount of capital it should retain and invest, and the returns it should be making on this investment. Using MWACC allows management to read these messages and set internal performance targets as appropriate to meet the required response.

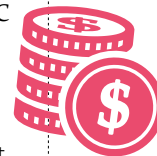
**Three further points to make are:**

1. By looking at total capital used, management must focus on all aspects, working capital and under-performing assets included.
2. The IRR profile can accommodate the timing of expected cash flows

where this may not be a smooth progression.  
 3. The progression of the KPIs used over several years will show a picture of true management performance over time.

**Conclusions**

This framework for embedding value creation into readily available and widely understood KPIs has applications both for measuring and incentivising management performance. 🍀



**Ben Walters** is deputy treasurer at Compass Group



\* The term MWACC is trademarked to the author

To contact the author about this approach to corporate finance, email him at benwalters73@yahoo.co.uk or join the debate at MWACC\_debate#

For parts one and two in this series, please see *The Treasurer*, April 2017, page 34, and *The Treasurer*, May 2017, page 36

**MWACC is the hurdle rate a firm must achieve on its investments in order to justify its current value**

# A CLEAN START

NEW ACCOUNTING PROVIDES COMPANIES WITH AN OPPORTUNITY TO REVIEW COMMERCIAL THINKING AROUND LEASING. MICHELLE PERRY EXPLORES THE IMPACT OF IFRS 16

For most public companies, it is less than two years before they have to report leases on balance sheet. Regulators have estimated that the accounting change will bring \$3 trillion of leasing commitments onto balance sheets, materially increasing the debt that must be reported. The impact of the accounting change is slowly emerging and, in some cases, prompting innovative responses.

The use of leases is concentrated on some industry sectors and companies more than others and for those, we can expect to see major changes in company reports. In certain cases, we may see commercial changes as well to mitigate the impact of IFRS 16, *Leases* – the new lease accounting rule, although rating agency Fitch says application of IFRS 16 will not affect its corporate ratings.

Over the past two decades, sale and leaseback transactions have become very popular, particularly in sectors and companies that required lots of big assets. By using sale and leaseback, a company's balance sheet implied a smaller asset base and less financial debt. But regulators argued that the picture was not a complete view of a company's actual position.

The final version of the accounting rule has taken more than a decade of negotiation and debate to finalise but, ultimately, the IASB in conjunction with the US standard setter, the FASB, concluded that the benefits – such as improved quality of financial reporting and better comparability – outweighed the costs of data capture and implementation.

IFRS 16 will result in a more “faithful representation of a company's assets and liabilities, and greater transparency about the company's financial leverage and capital employed,” the IASB says.

Stephen Cooper, IASB board member, says: “Investors and ratings agencies like it because it allows them to do fewer adjustments. They want more disclosure.”

The IASB expects the number of sale and leaseback transactions to fall as companies apply IFRS 16. This is because the new rule reduces management's incentive to use them, but the accounting should not affect the fundamentals of a business model.

“The accounting shouldn't in theory change the economic decision-making in a company. In practice, however, the fact that leases were off balance sheet gave companies a reason to lease. It was an artificial incentive to lease for the wrong reasons – so that bias in the system has been removed,” Cooper says.

There has been a mixed reaction from companies. But some like the rule and argue that the accounting should have changed a long time ago. German engineering group Bosch recently told an IASB conference that it would be adopting the change early. But it is unlikely that many other companies will follow suit.

## The effect of the reforms

Airlines, retail and hotels are sectors that will be materially affected by the reforms. However, even within each of these sectors, some companies will be significantly more impacted than others. According to IASB analysis, for 36% of retailers (73 of 204 companies),

“The accounting shouldn't change the economic decision-making”

the estimated present value of future payments for off-balance sheet leases to total assets was more than 50% as compared with 21.4% for all companies sampled in that sector.

Virgin Atlantic, like many airlines, has leased many of its planes over the years. Since 2014, the airline has implemented a new strategy to buy a greater percentage of aircraft with the aim of owning just over a third of the fleet by 2021. The airline's finance and treasury team worked proactively and rather innovatively last year to secure a landmark deal to restructure their finances in order to buy planes.

Last year, Virgin Atlantic arranged a £220m senior secured note transaction using the airline's takeoff and landing slots at London's Heathrow Airport – which scooped an accolade at the 2016 *Treasurer's Deals of the Year Awards*. (See *The Treasurer*, February 2017, page 25.) It was the first time in European air-transport history that airport slots had been leveraged in such a way.

“Virgin had always leased its aircraft, but it is now looking at owning between 30% and 50% of its aircraft. We used the deal to raise funds to buy some,” Nathan J Dunton, group treasurer, says.

“It's about altering the asset base to on-balance sheet debt and assets in line with the new accounting rules. Those [aircraft] are good assets and so having that expense of the asset isn't seen as such a big risk as it was in the past,” Dunton says.

He adds, however, that IFRS 16 was not the primary driver of this strategy and that the airline is still working through the full effect of the new accounting rule.

Karlien Porre, partner in Deloitte's treasury advisory services, says: “Treasurers may look to refinance arrangements based on the charges of the leases. Treasurers will need to manage and think through how it will impact cost of funding, debt covenants, credit ratings and interest rate on debt as debt will increase. The whole topic around managing the impact will be a big role for treasurers.”

Loan documentation is often worded such that covenants are tested using generally accepted accounting principles (GAAP) at the date the loan was negotiated, so companies will likely face the challenge when they refinance, rather than straightaway.

Not all airlines will necessarily look to own planes, either. BA Airlines, owned by



Spanish company International Airlines Group, has traditionally owned a large portion of its aircraft and will already have many aircraft on balance sheet. Some lower-cost airlines may continue to opt to lease planes. Their flight schedules and routes are seasonal and must be agile enough to respond to market and consumer changes.

“We don’t see leases disappearing completely,” says Alan Teixeira, global director of IFRS at Deloitte.

However, Jake Green, head of financial reporting at Grant Thornton, says that we can expect to see management seeking more flexibility in leases so companies can avoid capitalising them. Not all leases are required on balance sheet by the new rule. Short-term leases of 12 months and under, and leases of low-value assets won’t be included on balance sheet.

“Those companies that are cash rich may seek to buy assets, but many businesses will still want the flexibility. More risk sharing with the lessor and flexibility on leases with earlier break clauses will be needed,” Green says.

The situation is the same for retailers and hoteliers, too. Aside from their flagship stores and hotels, retailers and hotels will require the agility of a leased asset rather than a bought one, advisers say.

A lot will depend on a company’s position. Jessica Taurae, partner in PwC’s accounting consulting services, says: “It will probably come down to how much a company would have to borrow to buy an asset versus how much the lease payments would be. It’s a cost/benefit analysis issue. Could you get a good rate to borrow? Do you want to buy an asset or do you have cash lying around? Companies will be figuring all of this out.”

#### To lease or not to lease?

Analysts and professional investors in sectors where there are material off-balance sheet commitments have typically adjusted companies’ income statements to factor in any lease obligations, so it is unlikely to be a huge shock.

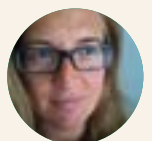
“As a result of new accounting rules, some companies are rethinking the

decisions about whether to lease, because the change has provided them with the opportunity to sit down and think about it. I’m sure companies are using this as a bit of a catalyst to review business decisions, as well as change their accounting processes,” Cooper says.

Leasing still makes good economic sense in many regards, particularly in an increasingly uncertain economic landscape. However, the new accounting rule is providing boards with another opportunity to review their leasing arrangements and consider the narrative they wish to provide investors, customers and other stakeholders ahead of 2019. It seems likely we will see more creative thinking along the lines of Virgin Atlantic’s leveraged landing slots over the new few years. ♡

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**Michelle Perry**  
is a freelance  
finance journalist



# THE RISE

## OF THE CORPORATE FINANCIAL RISK MANAGER



THE DISCIPLINE OF FINANCIAL RISK MANAGEMENT IS EDGING ITS WAY UP THE VALUE CHAIN. CLAUDIA VILLASIS EXPLAINS THE CONCEPTS, SKILLS AND QUALITIES INVOLVED

There is often a gulf between a job title and our understanding of what that job entails. I realised how abstract the title corporate financial risk manager was when I saw blank faces the first time I mentioned the name of my new role to family members. They understood only that I was managing something. I explained that my role was to look at market trends, review financial trends in currencies and commodities, and make my company aware of how those trends might affect it.

Many people might assume that bankers have a good understanding of corporate financial risk management, but not necessarily. Bank financial risk managers specialise in certain types of financial risk, especially products to manage financial risk. However, they tend to appreciate risk management in a corporate setting from a hedging perspective.

The appointing of corporate financial risk managers expanded after the global financial crisis. Previously, corporates were managing financial risks in a more distributed way, with tasks often shared across treasury teams. When companies realised that they

didn't have the information to properly manage all their financial risks and public awareness of issues, such as individuals making unauthorised transactions grew, specialist roles started to appear. Initially, individuals were deployed as risk controllers; they monitored risk, but weren't responsible for managing it. However, these were the first steps towards an independent, specialised financial risk management discipline that focuses on identifying, analysing, managing and reviewing financial risks. In practice, the discipline frequently also includes responsibility for enterprise risk management and compliance tasks.

Today, the core tasks of a corporate financial risk manager are to define the company's credit risk management policy (counterparty and country risk) and market risk (FX, interest rate and, in some companies, commodity price risk), reviewing and challenging it regularly.

The financial risk management policy's aim should be to support the overall business strategy

If a business doesn't have a good risk-reporting system, corporate financial risk managers often end up committing a lot of time to the necessary, but unattractive task of data collation and risk reporting. Every minute saved in producing reports is a minute that can be spent on performing the strategic part of the role. Looking for hidden risks and opportunities that are not apparent is a clear function of the role.

### A strategic approach

The financial risk management policy's aim should be to support the overall business strategy and not only about reducing or minimising risk. Positive scenarios and opportunities should be also analysed. The corporate financial risk manager should constantly challenge and revalidate current strategy, and look for potential risks and opportunities that haven't yet been considered. The aim should be that other functions and the business

understand the role as a business partner who can add value and improve risk outcomes for the business.

### Revalidating current strategy

Challenging the current risk management policy on a regular basis and from different perspectives can uncover some interesting outcomes. Risk management policies usually contain very general principles. For example, a company had the following statement in its policy: "The operating profit should be free from changes resulting from FX volatility". The corporate financial risk manager challenged this statement using the risk management cycle. This led to an enhanced outcome for the business. (See graphic):

**1. Identify:** The risk source where the invoices were in a currency different from the reporting currency. The transactions were seasonal and were forecasted by the accounting department.

**2. Evaluate:** A new cost-benefit analysis showed that it was beneficial to fix the exchange rate, ie hedge the exposures.

**3. Manage:** Risk was correctly transferred using financial derivatives such

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as forwards to fix the exchange rate.

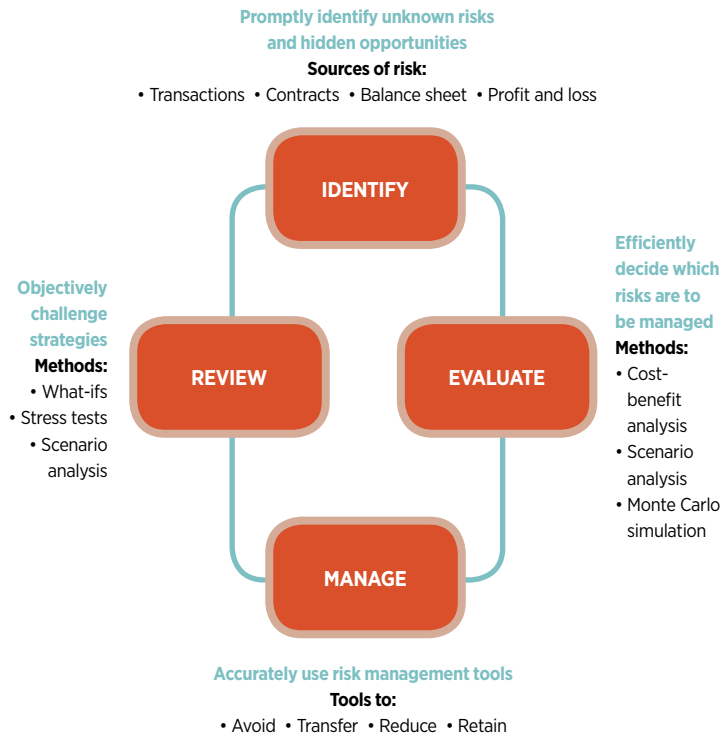
**4. Review:** A scenario analysis of past performance showed that even though the policy was adequate, FX volatility hadn't been reduced. On deeper review of the data, it became apparent the company was actually over-hedging. The volatility of the forecast was higher than the volatility of the exchange rates. Under this scenario, it was better for the company to stop hedging until a better forecast process was developed.

### Looking for risk and opportunity

Corporate financial risk managers cannot wait for the risks and opportunities to come to them, they need to work proactively. A level of experience is required to identify exposures, but the most important skill is to be able to think outside the box and engage with the business, including accounting, legal, tax, production, sales and procurement colleagues, all of whom can provide valuable information on sources of risk.

For treasury, corporate financial risk managers are in charge of analysing how the use of new financial instruments modifies the risk landscape. The analysis doesn't only consider financial risk, but also the impact of the new products on accounting, tax and regulation. A cleared product involves very different operational risk to an OTC derivative, for example. Cleared products require a focus on liquidity; and for OTC derivatives, complying with European Market Infrastructure Regulation and Dodd-Frank requirements is also critical.

When financing a capex project, the corporate centre might neglect to consider



## The key is to prioritise the risks that are more likely to occur and have a greater impact in the organisation

the functional currency of the entity when determining lending to that entity. While it might make sense for the corporate centre to finance the entity in the group's reporting currency, the FX movements and resulting FX gains and losses arising from the loan can lead to undesirable FX volatility. Since corporate financial risk managers are trained to see the broad picture, they can identify these scenarios before problems arise.

Corporate centres are usually in a better position to hedge the currency exposure than individual corporate entities.

Early discussions with accounting teams could reduce the effort spent on hedge documentation by establishing the right mix

of financial derivatives that is used to hedge risks and allows for a higher hedge effectiveness under the current IAS 39 requirements.

A risk strategy can also support sales when they need to maintain a certain price for a tender project or when selling products in a foreign currency. Together, they can analyse the different options and, in some cases, understand and predict what competitors are doing when selling in the same markets.

It is easy to get overexcited about the possibilities and opportunities. It must be kept in mind that new risk management strategies should not introduce additional complexity. A simple example of mistakes that could be made include,

for instance, the fact that the propeller of a ship is made of precious metals doesn't mean that the price of the raw material is a large component of the price of that propeller. For some products, the technology behind the product is more expensive than the commodities used in its manufacture. After an evaluation, it might or might not be worthwhile to introduce a hedging process to reduce residual commodity price volatility.

It is not always obvious which risks should be prioritised. When looking for new risks and opportunities, we are ideally guided by the strategic objectives of the company, but, in reality, risk management often comes down to a first come, first served approach. The key is to prioritise the risks that are more likely to occur and have a greater impact in the organisation.

To be a good corporate financial risk manager, you need to think beyond treasury. You can be part quantitative analyst, part IT or accounting specialist. You could become expert on regulatory issues or sometimes fill the role of auditor. You might need to be a consultant and deliver practical solutions and then become a project manager to implement them. Finally, you should hone your influencing skills, as you will need to sell your ideas to colleagues and managers. Acquiring this skill set, however, is worthwhile, as there are few roles that ask for, develop and reward such a broad experience and expertise. ♡



**Claudia Villasis** is a risk manager in group treasury at BHP Billiton



# Forging CONNECTIONS

BUILDING RAPPORT IS ESSENTIAL TO ESTABLISHING CONNECTIONS WITH COLLEAGUES AND CONTACTS. STUART DUFF SETS OUT SOME STARTING POINTS

Recently, PwC's Financial Services Institute outlined the major problems it feels that financial professionals will face across the next fiscal year. Many of these were related to automation – worries are high in the financial industry about jobs being replaced by automated machines.

However, the list of concerns didn't end there. The study also highlighted concern about issues ranging from the implications of Brexit on client behaviour and investment patterns; securing new paths to develop revenue as consumers become more interested in low-cost products; and issues around the successful spread of culture and ethics within a business.

To combat them, people in business will need to develop one skill above all others: the ability to build rapport.

After all, it is our ability to communicate warmly and develop human connections and rapport with others that separates humans from machines and allows us to demonstrate our value over a computer. It is rapport and relationship building that allows for the opening of doors towards new revenue, by making connections with potential clients and good business contacts. It is rapport and strong relationships with these

clients and contacts, which allow us to combat their uncertainties, and will help us to keep their investments and business behaviours steady. And it's rapport between colleagues that allows for the successful spread of culture and ethics from the top of a business right down to its entry-level staff.

Now, more than ever, it is vital that businesses and individuals work harder on their people skills – as these will help to weather the climate of uncertainty this year is bringing with it, as well as adding a level of value that a machine cannot.

Now, more than ever, it is vital that businesses and individuals work harder on their people skills

Building rapport is all about creating an environment, which allows genuine communication with others. This allows for connections to be made, ideas to be developed and productive working relationships to be formed. Thus, building rapport is not only important for making your working life run smoothly, it also helps to pave the way towards more creative solutions and greater productivity.

At Pearn Kandola, we've broken down the process of building rapport into its essentials.

## Common ground

Unsurprisingly, we communicate a lot of our ideas and thoughts through direct, verbal communication. Whether this is in a group setting with our peers at work, a more direct one-to-one setting with a line manager or someone we are managing, or even in front of a big group as we present or give a speech – having top-notch verbal communication skills is paramount for individuals who want to move up the ladder at work. However, non-verbal communication and body language is also a significant communicator.

We only need to look as far as the UK's current general election to see this in action. By the time this issue of *The Treasurer* reaches your desk, one of the two main contenders for prime minister may be yesterday's politician. But it has been interesting to see these very different individuals adapt their personal style for the campaign trail. While the campaign trail brought challenges for both, Jeremy Corbyn and Theresa May have provided very interesting examples of adapting body language and verbal communication

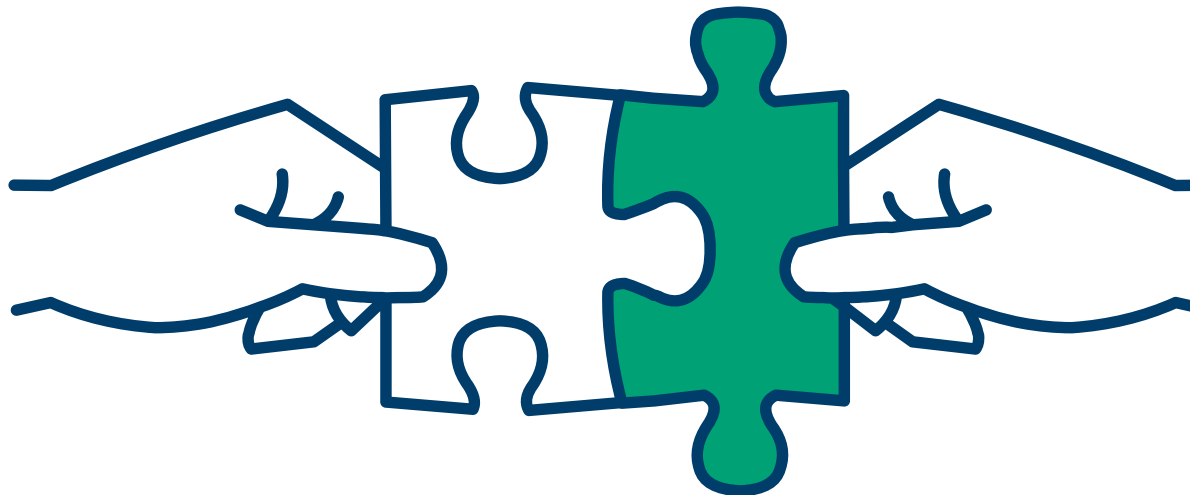
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to suit their specific target audience.

For example, Theresa May has communicated in a very serious and consistent way, reflecting her party's mantra around leadership. This has been exemplified through her stoic body language and constant repetition of the Conservative's main line, 'strong and stable', to describe their own party, and 'coalition of chaos' to describe the opposition.

Jeremy Corbyn, on the other hand, has changed his language and non-verbal communication quite dramatically during his campaign. He has dropped his 'Hs' and 'Ts', and rolled up his sleeves when speaking to one of his target audiences – the 18-21 student population. This is a clear attempt at mirroring their speaking patterns and presenting himself in a similar way to the youth of today. His recent face-to-face 'chat' with JME, a British rapper, perfectly highlighted a significant change in his communication style. Corbyn has clearly and consciously adapted his normal style of communicating to appeal to the people he is currently trying to target.

In the business world, other leaders have been lauded for their ability to articulate themselves well – and it has become clear across the past decade that the ability to present oneself in a positive and almost charismatic manner is vital for success. Bill Clinton, for example, was famous for building rapport with others through



## The way we position and hold ourselves is key to the way we are perceived by others

the way he spoke and addressed them. Steve Jobs, another famous communicator, was well known for his high levels of charisma and his excellent ability to communicate and resonate with others.

So, how do successful leaders like these build rapport when speaking to others? The answer is not as obvious as you may think. While humans do communicate most of their ideas through what they are saying, the majority of the cues we take from others come from non-verbal cues. In the case of communication, this can be through anything from the tone of voice to the way you are standing.

People enjoy the familiar in human interaction, so matching the verbal style of the person you're talking to can strongly influence rapport. By reflecting the communication preference

of an audience, you can make them feel more at ease and validated: something that is highly useful for building a strong relationship and laying the foundations for your ideas to be received positively. This is best achieved through the following methods:

- **Match their volume** – Matching someone in volume implies that you're on the same wavelength as them, and you're less likely to be viewed as threatening or weaker if you match the level at which they are using their voice.
- **Use their words and references** – The language someone chooses to express themselves gives an idea of how they perceive the world. By matching their speech and their mode of expression, you show that you understand them and the way they think. This will help to build rapport.

### Using the body

As we've seen, it is not just the way we speak that can help us to build better relationships with others. Just as the non-verbal part of how we express ourselves is important, so, too, is the way in which we utilise our bodies. The way we position and hold ourselves is key to the way we are

perceived by others – which is why the use of body language has long been an area of fascination for many.

Perhaps the most important body language technique you can use is mirroring. This involves directly matching the body language of someone you are speaking to: usually by holding yourself in the same way, or utilising the same gestures. This can encourage an easier flow of communication without the other person thinking you're making an extra effort – making rapport seem natural.

The above techniques may seem simple; however, understanding how to use them properly in a professional context is vital for building rapport and laying the foundations for strong relationships. As people skills increasingly become more relevant in the financial industry – due to the volatile nature of the world's financial stage and the rise of automation – it is vital that professionals work on these key skills, to ensure they remain successful within the business world, developing strong bonds that will help their organisation to thrive. ♦



**Stuart Duff** is head of development at Pearn Kandola, business psychologists





LIQUIDITY AND CASH FLOW ARE AS CRUCIAL TO A BUSINESS AS BLOOD FLOW IS TO A HUMAN PATIENT. DOUG WILLIAMSON SHARES TWO DIAGNOSTIC TESTS AND PRACTICAL APPLICATIONS TO PROMOTE FINANCIAL HEALTH

# LIFE BLOOD

Our organisation's liquidity is its ability to pay its obligations when they fall due, and so safeguard continuing operations. As treasurers, we are responsible for ensuring liquidity at all times. Failures can be expensive, even fatal.

## Diagnosis

Happily, a number of diagnostic tests for liquidity have been developed. These can give us early warning of any growing problems. Among others, these tests include liquidity ratios. Let's explore two practical liquidity ratios, starting with the current ratio.

### Current ratio

Do we have enough current assets in hand to pay our current liabilities?

This simple assessment assumes our current assets could all be converted into cash in time to pay the current liabilities, and without loss compared with their accounting, or 'book', values.

### Health check

Let's assume we work for OpCo. Our new assistant Alex has provided the following data, extracted from OpCo's internal accounts.

Alex's data (€m)	
Current assets	23
Current liabilities	11

Let's calculate our current ratio, using this information. Then we'll explore what this number is telling us about our liquidity.

A simple formula for the current ratio is:

$$\begin{aligned} &\text{Current assets} / \text{Current liabilities} \\ &= 23 / 11 \\ &= 2.09 \text{ times} \end{aligned}$$

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The current ratio is just over 2.0. This indicates that our current liabilities would be covered, more than twice, by our current assets.

### What else does the current ratio mean?

A higher current ratio is usually associated with stronger liquidity, but it may also be a symptom of inefficient working capital management.

Comparison of the current ratio over time, and with similar organisations, can give a useful early-warning indicator of matters that need investigation, and potential improvement. The current ratio can be especially useful for analysing financially distressed companies.

### Is OpCo's current ratio optimal?

There's no such thing as an ideal, or optimal, level for a financial ratio. An appropriate level depends on many factors, including the maturity of the business, the sector and any regulation. A typical current ratio for a manufacturing firm might be between 1.5 and 2.0. By contrast, supermarkets tend to have current ratios well below 1.0.

All tests and ratios are best used as elements within a comprehensive toolkit of investigations. We should never rely on the results of any single test to give a clean bill of financial health.

### How liquid is the inventory?

The current asset least likely to be fully liquid in practice is our inventory (stock). It can be difficult to turn inventory into cash quickly, for its full book value.

To take this potential lack of liquidity into account, the 'quick ratio' excludes inventory from current assets. The quick ratio is also known as the 'acid test', or the 'acid test ratio'.

#### Quick ratio

Do our current assets, excluding inventory, cover our current liabilities?

Both the current ratio and the quick ratio should be treated with caution. In cases of financial distress, debtors may not pay their potentially insolvent supplier, and the recoverable values of receivables (debtors) might turn out to be much less than their book values.

### OpCo's quick ratio

Turning back to OpCo, Alex helpfully investigates further, and now gives us the following split of total current assets.

Current assets split (€m)	
Inventory	14
Other current assets	9
Total current assets	23

A simple formula for the quick ratio is:

$$\begin{aligned} & \text{Current assets excluding inventory} / \\ & \text{Current liabilities} \\ & = 9 / 11 \\ & = 0.82 \text{ times} \end{aligned}$$

OpCo's quick ratio is less than 1.0. This indicates that current liabilities are not covered by the more liquid of our current assets. This is a warning sign. We decide to investigate further, starting with our liabilities.

### Should we include our overdraft?

Alex asks us whether our €20m overdraft counts as a current liability. It was not included in the €1m figure for liabilities reported earlier.

Yes. Overdrafts are indeed a current liability. They're repayable to our bank on demand. We can't ignore them for liquidity assessments, so we need to correct Alex's earlier figure for current liabilities, to include our overdraft.

With this correction, our current liabilities are:

$$11 + 20 = \text{€}31\text{m}$$

### You have a go

Using this updated information, recalculate the current ratio and the quick ratio. (\*Check your answer.)

### Can we improve liquidity?

Yes. It's important to make sure that receivables are collected promptly, and that payables are not paid too quickly, subject, of course, to maintaining relationships with customers and suppliers. Inventory should also be maintained at appropriate levels, and managed efficiently.

Any short-term simplistic responses to liquidity problems may have adverse consequences, temporarily masking symptoms while the underlying condition deteriorates.

#### Side effects

In business, as in physics, every action is met with an opposite reaction. For example, delaying payments to vendors may reduce working capital needs over the short term, but any benefit is likely to disappear over time, as vendors adjust their pricing accordingly.

Restriction of cash is like restricting blood flow as the patient 'withers on the vine'. Severance of cash is like a blood clot or severing a major artery; it quickly becomes terminal. Successful recovery needs both speed of repair and identifying exactly where the restriction or severance occurs.

*John Mardle, managing director, CashPerform Ltd*

### Financial health insurance

A further response could be to replace some of our overdraft funding with longer-term borrowings. This would stabilise our funding base by converting short-term liabilities into longer-term ones. A related benefit would be to provide more flexibility and time to engage successfully with any future crises.

### Take a learning health check

The best test of your learning is whether you can answer questions under time pressure. Take a learning health check now, by attempting the quizzes or assessment papers on your learning website.

### Will it hurt?

Testing yourself in this way will provide you with an accurate measure of the areas where you need more learning and practice. Realistically, any further learning you do won't be entirely pain-free. But it will bring predictable and healthy added value to your organisation and your career.

*With many thanks to John Mardle for his valued guidance.*

**Doug Williamson is a finance and treasury coach**



# A LAW FOR RANDOM THINKERS

**Benford's law has had mathematicians scratching their heads for decades. How does this statistical oddity stack up?**

Randomness is a topic that has cropped up in a number of conversations I've had within the past few days. How random was that? No, that's not a rhetorical question. Seriously, how random was that?

In life, random events tend to clump together, of course. Your mother told you this when she said, "Bad luck comes in threes."

But there is one element of randomness that seems hardly to be random at all. In 1881, an American astronomer called Simon Newcomb noticed that the first pages of books of logarithms were much more well thumbed than the middle or back pages. It appeared, he noted, that people were doing more calculations with numbers beginning with the digit '1' than with the digit '9'. He even worked out a mathematical formula that described how often a number beginning with each particular digit was consulted (where D is the digit in question):

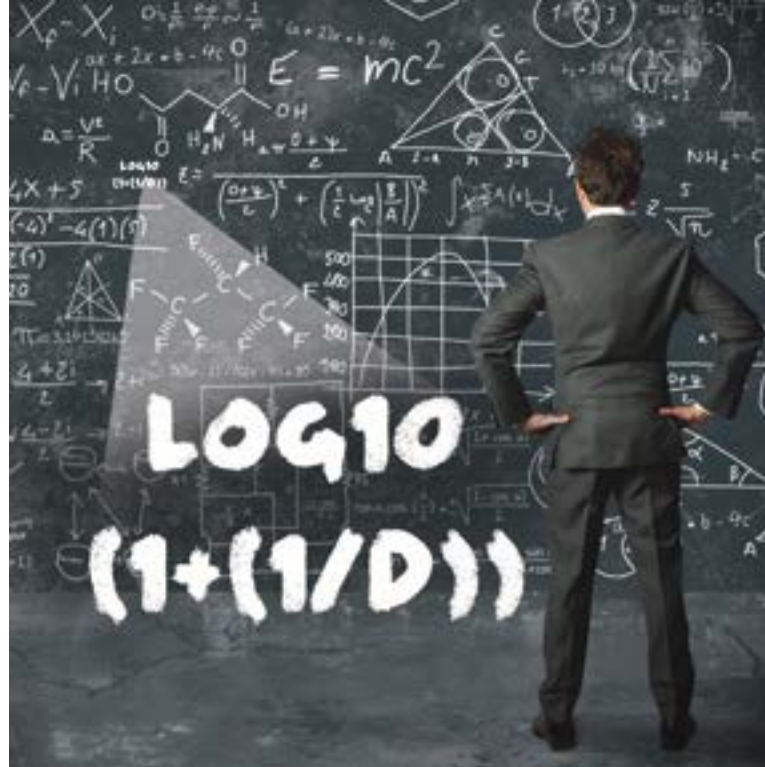
$$\text{Log}_{10}(1+(1/D))$$

So people were looking up numbers beginning with a '1' about 30.1% of the time, numbers beginning with a '2' around 17.6% of the time, up to those beginning with a '9' just 4.6% of the time.

No one could figure out why this was, and so everyone forgot about it.

Almost 60 years later, a US physicist called Frank Benford made the same discovery. But he delved into it in more detail and found out that this mathematical weirdness of digital 'clumping' occurs much, much more frequently than we might think and applies to phenomena beyond that of how well thumbed a book of logarithms happens to be.

The law – which would soon be known as Benford's law and not, sadly, Newcomb's law – actually occurs a great deal in nature and applies to almost any naturally occurring phenomenon that has no artificial upper or lower limits. So, for example, it



applies to the drainage area of the world's rivers measured in acres; it applies to the population of US counties; it even applies to the numbers that appear in magazine articles. It doesn't apply to the price of a litre of diesel at UK petrol stations. But it does also apply to the drainage area of the world's rivers if measured in *hectares*.

There's even a variation of the law that applies to the second digit in any number. The consequence of this is that numbers beginning with '10' are much more common than those beginning with '99'.

Of special interest to treasurers is the fact that the law applies to share prices, financial transactions and bank balances. The law has been used by auditors to look for improper expense claims or fraudulent deals: people usually either submit claims such that they are just below a limit that attracts attention

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or they go excessively random. Either way, they fall foul of Benford's law and get caught out.

There's a wealth of academic literature that scrutinises the mathematics, examining things like probability distributions of probability distributions (yes, you read that correctly; no, you're not seeing double). But in truth, no one seems any the wiser as to exactly why Benford's law works.

Maybe it's just one of those random laws of nature. ♦



**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 June 2017 issue of *The Treasurer* include: **Grosvenor Group treasurer Karen Toh talks about her organisation's treasury-transformation project, on page 24.** **Treasurers share the ways in which they accurately forecast cash visibility, on page 30.** **The situations that will prompt a board to request information on cash and liquidity, on page 40.** What does a corporate financial risk manager do? Find out on page 42

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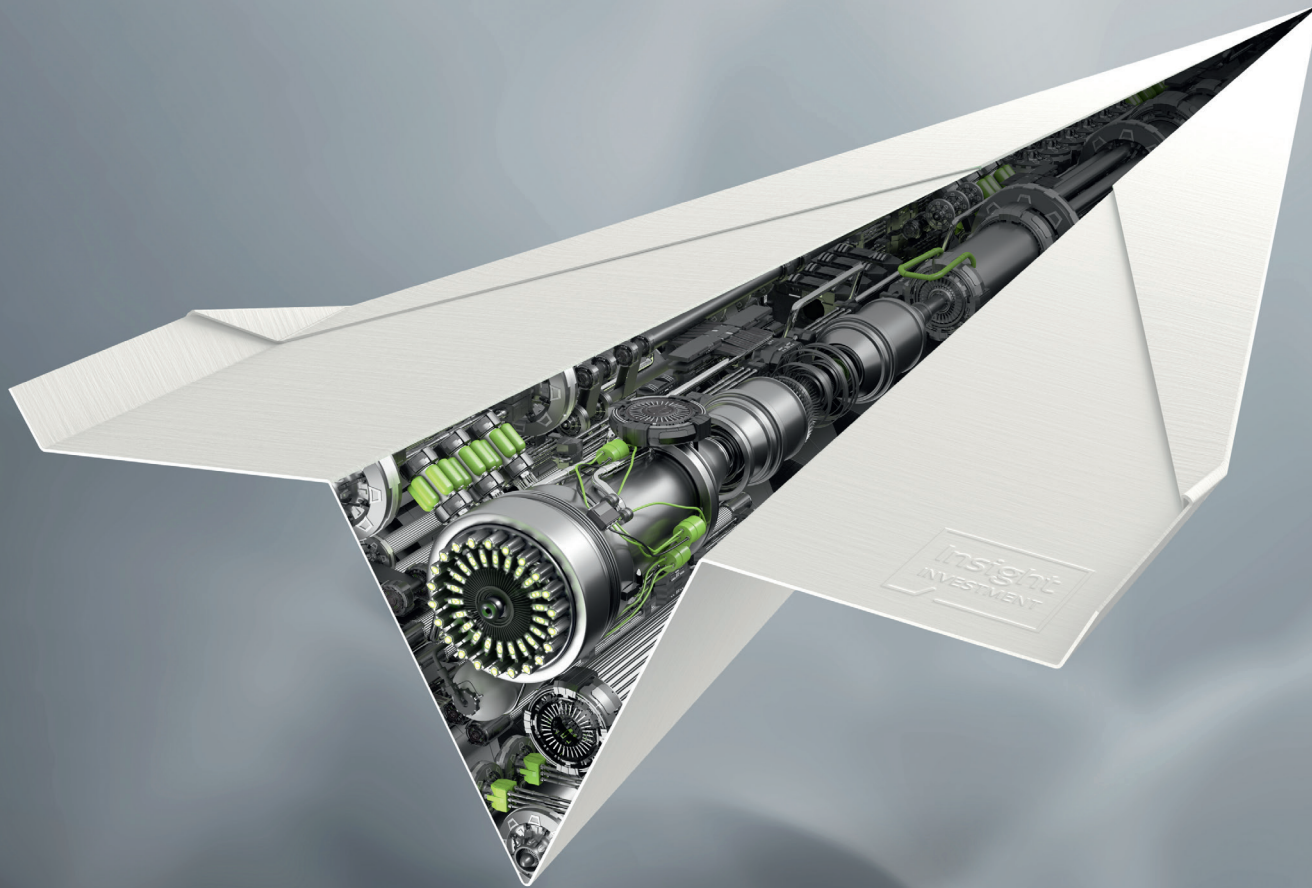
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<sup>2</sup>All data as at 31 December 2016.