# Treasury Risks and Uncertainties 2017

Risk, the objective probability of some undesired event happening, and the management of risk are central to the treasury function and there is no shortage of risks in 2017. But uncertainties, where there is only the subjective probability of something happening, could well provide more significant issues for treasuries in the coming year. The following paper offers TAG's assessment of some key risks and uncertainties that treasurers will face in 2017 along with suggestions to manage and mitigate them.

## Risk

In the risk category two closely related items stand out: payments fraud and cybercrime.

***Payments Fraud:*** A recent Federal Reserve Bank study estimated $6.1 billion in unauthorized third party fraud occurs annually and that is only the tip of the fraud iceberg. In addition, in a recent AFP survey 73% of corporations reported payment fraud attacks in 2015 with 71% of surveyed companies indicating check fraud was a problem. Although this puts checks at the top of the list, fraud involving wire, card and ACH is also a significant issue for most companies.

Many companies approach payments risk on a channel-by-channel basis. For example, they address check fraud with blank check stock, secure printers and payee positive pay while ACH fraud is tackled through account structure, filters, blocks and authorization protocols. These siloed approaches reduce payments risk, but fraud is a systemic problem and needs to be addressed systematically. Payments have always been essential to the operation of a business, but there has been an explosion in new payment channels and systems—each with potentially unique risk profiles.

Treasury faces the demand for new payment channels with their related challenges from multiple directions. Some of the demand is coming from the business side of the company. Customers demand convenience so it is up to treasury and its business partners to find a way to deliver. The increased adoption of technology is also forcing corporate treasury to work with procurement and business operations to provide on-line solutions for outbound payments. But solutions need to be addressed at a strategic level with a review of all payment activities, sys-

tems and controls. A comprehensive corporate payments strategy is an essential first step in efficiently controlling payment costs and complexity as well as reducing payment fraud.

***Cybercrime:*** This risk often encompasses payments fraud but casts a wider net. Companies embrace hyper-connectivity and rely on the internet and other networks to function efficiently. But this dependence on computer networks creates a target-rich environment for rogue states, terrorists and thieves. Cyberterrorists include those trying to interfere with business in general through a denial of service attack, state-sponsored entities wanting to speed up their research and development through the theft of intellectual property and, of course, the basic thieves who thrive in cyberspace because many victims do not properly secure their virtual doors.

Just one employee opening a suspect email attachment or going to a directed link on the web can introduce a malware infection. The 'bring-your-own-device' culture and mobile revolution have given employees expanded choice about where and when they will work along with the tools they will use but have complicated corporate responsibilities. Many new technologies are not as thoroughly tested as one might want. So, the opportunities for compromised systems are very high. The reality is that every company will likely be breached at some point.

From a risk management standpoint, the question is "what's the most prudent way to operate in this shifting reality?" The simple answer, but one that many companies have not undertaken, is to create a cross-departmental cyber-risk committee. Such a group should develop a focused approach to reviewing all areas across the enterprise where the potential of cybercrime may exist. The process is multi-faceted and should include: assessing payment and collection techniques and instruments; ensuring procedural policies and protocols are in place; reviewing all customer, vendor, bank and cloud interfaces; increasing employee awareness and training; and instituting changes where needed. This is a fairly labor-intensive approach, but it is the most thorough way of addressing the potential of cybercrime and will pay off in the long run.

## Uncertainty

It would take a brave forecaster to have foreseen Brexit and the general frustration with "the establishment" for political events in 2016. This environment leads to global volatility and business challenges beyond the headlines. For Brexit, these include the impact on tariffs between Britain and the rest of the EU as well as centrally negotiated treaties across the globe; the role of London as the financial center of Europe; FX exposure with the drop in the value of GBP among just a few. And implementing new trade agreements will not be an easy task.

Managing this uncertainty from a treasury perspective is simpler than it may seem at first. The good news is that treasury is typically not the main driver behind investment decisions, acquisitions or the location of factories or service centers. For the items that are broadly in-scope no change is required, just due diligence in execution. Treasurers should not be deterred by the volatility from executing FX, but it might make sense to review and, if necessary, update any policies regarding hedge limits and other parameters to ensure they fit your needs. More than ever it will be important for treasury to have good face-to-face connections with global operations and the financial partners that support them.

Uncertainty exists in two major areas: Tax and Regulation

***Tax:*** Tax and regulatory concerns are traditional matters for treasury made even more important because of increased global volatility. Many multinationals in the US and elsewhere were alarmed by the potential disruption from the proposed changes to IRS section 385. The panic proved unnecessary as October 2016 brought the "permanent and temporary" regulation that specifically exempted short-term treasury arrangements. Section 385 actually rewards companies that have exercised general prudence in treasury management and flushed out the substantial constituency for cash management arrangements, as they demanded clarification on the proposed regulations. The lesson from Section 385 that can extend to tax matters in general is that clear awareness of treasury techniques employed in intercompany arrangements coupled with good quality documentation, arm's length pricing and interest rates will always be critical.

***Regulation:*** There are two major areas of concern for regulation issues.

Basel III: This directive continues to loom with its liquidity ratio and capital adequacy requirements affecting banking decisions. Added to the mix are concerns about how new governments may respond to multilateral regulations such as those from the BIS and the BCBS. Dodd-Frank complicates the issue in the U.S and the eventual direction of the new US administration only increases the short-term concern. Hoping something will go away is never a good idea and so treasurers need to be aware that the regulators enforcing Basel are more likely to look at bank accounts and transactions and may require that banks use gross amounts in calculating and reporting liquidity ratios. This will in turn oblige banks to keep more liquidity on their balance sheets—or reduce the number of accounts. All of this affects pricing and availability of pooling products specifically and all bank products generally.

Base Erosion and Profit Shifting (BEPS): This initiative from the OECD addresses the digital economy, tax treaties, financial sleight of hand, treaty abuse, transfer pricing and more. It will be implemented on a country-by-country basis with the strong possibility that interpretation and compliance standards will vary. It is quite clear that now is not the time to push the envelope with complicated treasury structures designed to shift profit to lower tax domiciles, set up thinly capitalized businesses or make other financial arrangements—particularly with transfer pricing—that may come under scrutiny with BEPS implementation. It is also obvious that, once again, good documentation will be an essential part of treasury's response to BEPS.

## Summary

2017 will certainly be an eventful year for many reasons and interesting times often create uncertainty and generate risk. The clearest risks will arise from payments fraud and cybercrime. The rapid pace and volatility of geopolitical events have increased financial uncertainty directly impacting regulatory and tax concerns. Warren Buffet put it well when he said, "risk comes from not knowing what you're doing." Now is the time to develop your overall payments and risk management strategies to deal with risks and uncertainties making sure you do know what you are doing and why you are doing it. Review policies and procedures to make sure that they are appropriate for the company's business needs and circumstances. Review documentation to ensure that it is complete and will meet regulatory requirements. Good planning now helps ensure that risks are mitigated and that the uncertainties do not become problems in the future.

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