Why Risk Management ~~is~~ should be Treasury’s Biggest Priority

Presented by
Bob Stark
Vice President, Strategy

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Treasury = Risk Management

Everything in treasury also helps manage risk

- Cash & Liquidity (risk)
- Bank Account Management
- Foreign currency management
- Interest rate hedging
- Payment fraud and cybercrime
- Operational risk
- Regulatory compliance
- Business continuity
- Reducing counterparty exposure
- Supply chain risk

Treasury = Risk Management

By managing cash, payments, liquidity, bank accounts…

- We are succeeding at treasury
- *But we are also reducing risk for the organization*

If we think about treasury in terms of mitigating risk:

- ✓ CFO is more interested
- ✓ Value-added projects are better funded
- ✓ Your successes are more measurable
- ✓ You get a gold star

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Treasury = Risk Management

Cash & Liquidity

Financial Risk

Operational Risk

Business Continuity

Counterparty Risk

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Liquidity Risk

What are the risks?

1) Insufficient cash (or access to cash)

2) Cash immobility – funds in the wrong places and/or unable to be deployed

Added challenges

- Cash scrutiny by investors
- Funding share repurchase and dividend decisions
- Held offshore
  - Tax implications
  - FX risk

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Liquidity Risk

Solutions

- Global visibility
  - No dollar, euro, yuan or peso should be unknown
  - Visibility = tool to manage counterparty, FX, liquidity
- Perfect the cash forecast
  - Build comprehensive forecast through multiple sources and models
  - Must measure the effectiveness of the forecast. Without such measurement, you have wasted your time
- Cash mobility
  - Create right structure (e.g. pooling) to ensure cash is concentrated and mobilized

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Financial Risk

What are the risks?

1) Certainty and predictability of cash flow and earnings targets
2) Translation losses at each quarter end

"Foreign exchange losses represented $0.02 of EPS and led to missing analyst estimates"

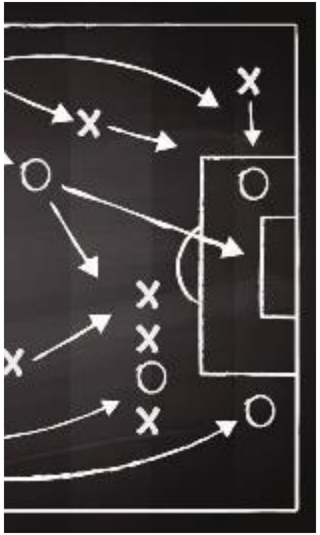
Added challenges

- Hedging policy (if it exists) may not provide adequate flexibility to hedge away risk
- Stakeholders unlikely to appreciate tactical challenges in exposure management

Financial Risk

Solutions

1) Visibility into non-USD cash
2) Effective Cash Forecasting
   – Need full confidence in future cash flows
   – Otherwise will under hedge, reducing program effectiveness
3) “Collaborative” Hedging
   – Partner with colleagues to smooth the effect of hedge accounting and other regulatory requirements that result from hedging programs
4) Effective Reporting
   – Measure success offered by hedging



Operational Risk

What are the risks?

1) High error rates
   - Spreadsheets are great at hiding mistakes!
   - 85-95% of spreadsheets contain errors, from incorrect formulas to re-keying errors

2) Lack of workflows and audit trail
   - Not having separated duties and a centralized record of ‘who did what’

Added challenges

- Compliance
  - Can be external - Sarbanes-Oxley, FBAR, hedge accounting, OFAC
  - Can be internal information security policies

Operational Risk

Added challenges - Compliance

Treasury must be experts in compliance, including nuances of how to *most efficiently comply*.

FBAR: Must track bank accounts, signatories, and bank balances to provide complete reporting for treasury or tax to file FBAR documentation for the corporation and individuals.

OFAC: Require payment screening capabilities and list management to provide notification of anti-money laundering hits on OFAC, EU, and UN watch lists.

EMIR: Detailed trade reporting and communication to trade repositories.

Basel III: Categorization of cash forecasts into operational and non-operational groupings to optimize investment opportunities in the Basel III landscape.

MM fund NAV: Upcoming floating NAV and other MM fund regulations

SOx: Require structured and auditable workflows so that finance teams can demonstrate audit and controls for cash management, payments, bank accounts, and other separation of duties and data loss preventions.

Hedge accounting: Track derivatives, designate derivatives for hedges, prove effectiveness of hedges, fair valuation of derivatives, designate change in value to balance sheet/income accounts

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Operational Risk

Solutions

1) Automation
   - Eliminates rekeying and formula problems
   - Cannot be justified on time savings alone (CFOs don’t care about that)

2) Documentation
   - System documentation
   - SOC1 and SOC2 reports

3) Compliance features & reporting
   - Ability to track, calculate, report to expedite compliance efforts

4) “Auditor login”
   - Let them find the info or run the report themselves!

Fraud & Cybercrime

Spear Phishing

- Cybercriminals are specifically targeting…you
- Attacks prey on:
  - Weak login & authentication procedures to gather data
  - Inconsistent workflows and policies to execute scheme
- Attacks are quick and lethal; one mistake or exception from policy is all that it takes

Fraud & Cybercrime

Internal Fraud

- Cybercrime is actually not the most likely fraud scenario
- Employees are more likely to commit fraud because they know:
  - Systems, policies and their weaknesses
  - How fraud is detected
- As with cybercrime, attacks prey on:
  - Weak login & authentication procedures
  - Inconsistent workflows and policy execution

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Fraud & Cybercrime

What are the risks?

1) Unauthorized payments
2) Cash withdrawals
3) Shutdown of treasury
4) Data loss – PII, treasury "intel"…anything that can lead to phishing success

Added Challenges

- Spear phishing and BEC schemes proving more sophisticated
- Attack may not be on treasury, but affect treasury area of responsibility (e.g. supplier payments)

Fraud & Cybercrime

Solutions

1) Protected login to systems
   – Multi-factor authentication, IP filtering, VPN, Single-Sign-On, etc.
2) Data encryption
   – In transit and at rest in the database
3) Payment standardization
   – Single payment policy globally – bank, payment type, system of origin, and global region
   – Consider use of digital signatures for better authentication and non-repudiation by banks
4) Control bank accounts
   – Visibility into all accounts – with sunset procedures to banks
   – Consider segregation of duties for open/close and maintenance

Business Continuity

What are the risks?

1) Loss of personnel (treasury team wins the lottery)
2) Loss of facilities (company offices unusable)
3) Loss of services (company offices lose key services such as power or internet)
4) Loss of access (unable to access company offices if there is a snowstorm)

Added Challenges

- Information security policies/procedures cannot be sacrificed
- IT may be responsible for planning – but don't know treasury needs

Business Continuity

Solutions

1) Standardization of workflows
   - Eases onboarding of new employees
   - Eases consistency of process outside head office
2) Continuous Availability
   - If systems 24/7/365 (or close), minimizes likelihood of executing BCP
3) Disaster Recovery
   - More than just database backup
   - Need to be up and running on everything - *data, reports, bank connections, ERP interfaces, security protocols, login procedures, URL to access cloud portals*
4) Third party audits
   - SOC1 and SOC2 audit reports

Counterparty Risk

What are the risks?

1) Is your cash and liquidity safe?
   - Banks and creditors
2) Will partners live up to their financial commitments
   - Banks (e.g. execution of derivative contracts)
   - Customers and Suppliers

Added challenges

- Global expansion increases risk
  - Lower familiarity with banks, customers, suppliers
  - Introduces sovereign/country risk

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Counterparty Risk

Solutions

1) Counterparty Exposure reporting
   – Must look at all financial variables, including derivative and credit line exposure
2) FX impact
   – Need to know what currency variables counterparties are exposed to
   – Determine how counterparties price-in exchange risk
3) Macroeconomic impacts
   – Understanding how economic environment will impact business (e.g. Brexit, terrorism incidents, weather all have economic implications)
4) Centralize visibility
   – Even if some activities are decentralized, must have overarching view to ensure control and rapid response

Counterparty Risk - Supply Chain

What are the risks?

1) Supplier illiquidity
   - Likely disruption of goods/services being provided to your company

2) Lack of supplier growth
   - Inability to meet growing demands from your organization
   - Can’t benefit from economies of scale – e.g. reduced costs for higher order quantities

Added challenges

- Treasury objective: hold cash
- Finance objective: improve working capital (including DPO)
- Multiple cooks in the kitchen (Treasury, A/P, Procurement, Credit, etc.)

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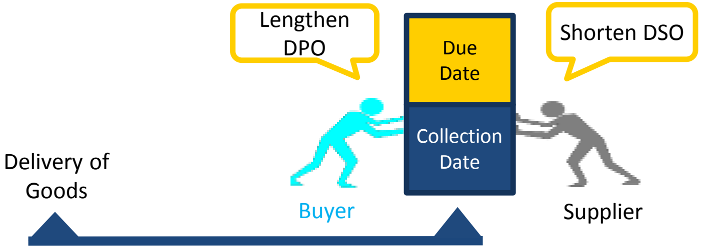
Supply Chain Risk

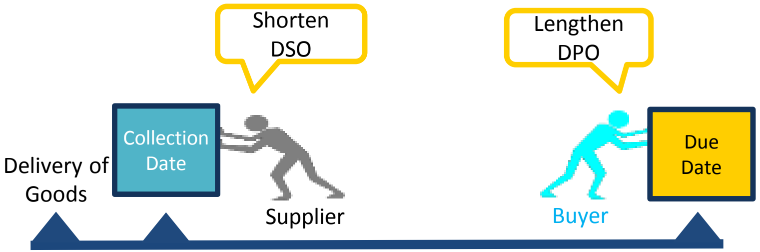
Holding Cash & Delaying Payments

"Buyers Rule; Suppliers Drool"



Potential for everyone to win

"Heads I Win; Tails I also Win"



CONFLICTING OBJECTIVES

- Longer payment terms reduce suppliers' liquidity and margins
- Supplier's access to receivables finance can be restrictive and costly
- Aggressive negotiation of terms can create damaging friction

HARMONIZED OBJECTIVES

(By separating invoice due and collection dates through financing program)

- Buyers improve liquidity by extending terms
- Suppliers accelerate access to non-recourse, off-balance sheet receivables funding
- Lower funding costs can improve cost of goods, and thereby margins

Supply Chain Risk

Solutions

1) Supplier financing program
   - Pay suppliers earlier (in return for a discount)
2) Cash & Working Capital Visibility
   - Do I have the cash reserves to pay early?
   - Is the ROI of paying early compelling?
   - What are DPO consequences of paying early (and can I accept that CCC degradation)?
3) Potentially incorporating third party financing
   - If you don’t want to use your own cash, use someone else’s
   - Often terms allow for extension of DPO ➡ improved working capital

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Summary

- Risk is more than FX and Interest Rates
- Operational risk management needs to take more of our time
- Underestimating fraud prevention and business continuity is like saying no to car insurance
- Supply Chain is being more prioritized by CFOs as one of biggest opportunities to (unlock cash and) reduce business risk

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Questions?

Bob Stark
bob.stark@kyriba.com
@treasurybob

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