



TREASURY RESOURCES

@ *PhoenixHecht.com*

This presentation was originally given by:

Donald Yarbrough, Sr. Vice President
Cindy Hu, Assistant Vice President
Treasury Management
Amegy Bank

At the 2007 TEXPO

For questions about this material contact Donald at:
donald.yarbrough@amegybank.com

CTP - Essentials of Governance, Pension Management and Bank Relations

Donald Yarbrough, Sr. Vice President
Cindy Hu, Assistant Vice President
Treasury Management

Corporate Governance & Ethics

- **Considerations:**
 - The role of independent directors.
 - Outside and internal auditors.
 - Financial reporting.
 - Investor relations.
- **Direct impact on Treasury**
 - 2002 Sarbanes – Oxley Act (SOX).
 - Expensing of stock options.
 - AFP Code of Ethics.

Corporate Governance

Major concern for large, publicly traded companies in the U.S. Issue for foreign owned companies only if Stock is traded in U.S.

Key parties:

1. Public Company Accounting Oversight Board – created as a result of SOX.
2. The New York Stock Exchange Board of Directors.
3. The Securities and Exchange Commission (SEC)
4. Large institutional investors
5. State attorney general offices.
6. Independent organizations such as the Conference Board.

The Issues of Corporate Governance

- Ownership versus Control.
- Stockholders are the owners/investors.
but
- Officers (executives) control the company independently of Owners.
- Passive owners/investors often results in free reign for the management, which can lead to reduced shareholder value.
- The “Agency Problem” between management and stockholders
- **Corporate Governance** – set of checks and balances to protect owners/investors.

Components:

- Board of Directors
- Independent auditors
- Regulatory agencies

Independent Directors

- **SOX and NYSE standards for Independent Directors.**
 - Increase role and authority.
 - Tighten Definition.
 - Shareholder opportunity to monitor/participate in governance.
 - New control/enforcement mechanisms.
- **Tighten Definition**
 - Director must not have a “material relationship”.
 - Must regularly meet without Management.
 - Five year “cooling off” period.
- **Increase role and authority.**
 - Independent directors must comprise a majority.
 - Nominating committee, compensation committee and audit committee comprised entirely of independent directors.

Shareholder Participation

- Shareholders now have greater influence over Stock option plans.
- Shareholders granted more access to key governance information, such as:
 - Codes of conduct and ethics.
 - Key committee charters.
 - Prompt disclosure of waivers for directors & executives officers.
- **Control and Enforcement.**
 - CEO's held accountable for complying with NYSE standards and accuracy of information.
- **Upside:**
 - Attract shareholders.
 - Retain shareholders.
 - Renewed investor confidence.

Independent Auditors

- **SEC prohibits auditors from:**
 - Tax shelters advice.
 - Legal and management advice.
 - Financial software development.
- **SEC requires disclosure of fees paid for auditing and consulting.**
- **Disengagement of long-service audit partners.**
- **Companies required to assess internal controls for financial reporting.**

Public Accounting Oversight Board (PCAOB)

- **Created by SOX to:**
 - Improve quality/transparency of financial reports.
 - advance corporate responsibility.
 - further the public interest.
- **SEC appoints the chairman and members.**

SARBANES - OXLEY

- **New regimen re:**
 - Auditor Oversight.
 - Accounting and Reporting.
 - Corporate Governance.
- **Section 302:** CEO and CFO must personally certify the accuracy and completeness of financial statements.
- **Section 906:** penalties for noncompliance.
 - up to \$5 MM and 20 years in prison.
- **Section 404:** Managers responsible for establishing and maintaining adequate controls. Auditors required to report on management's performance assessment. Significantly higher audit costs.
- **Sub certification:**
 - Helps to ensure accuracy and completeness.
 - Verbal or written certification of financial information by those providing it. Can include treasury and finance departments.
 - Important role for financial professionals.

Ethics

- **To institutionalize treasury ethical conduct:**
 - Establish a code of conduct.
 - Treasury policies and procedures.
 - Treasury Ethics Training.
- **Code of Conduct to Incorporate the following recommended elements.**
 1. Confidential Information, including bank-account information, passwords, etc.
 2. Conflicts of Interest, including acquisition of stock, solicitation/acceptance of gifts, avoiding actual as well as apparent conflicts.
 3. External Activities – should not interfere with job performance or create a conflict of interest.
 4. Employee Conduct, including: On-the-job – Attire, hours, personal use of phones, email and Internet. Personal habits – Gambling, alcohol, personal finance.
 5. Conformance to code.

Policies and Procedures for Treasury

- Establish responsibilities, behavior and penalties.
- Allows company an effective way to inform employees/others.
- Regular review recommended.
- **Treasury Ethics Training**
 - Most effective way to instill desired behaviors.
 - Offsite training, sessions. Discuss:
 - Management's concerns.
 - Recent cases.
 - Hypothetical situations.
 - Code of Conduct & Policies and Procedures.
 - Reporting of violations.
 - Insider trading.
 - Reporting requirements.

Investor Relations

- **Goal:** Achieve fair valuation of company's securities.
- Integrates law compliance re: finance, communication, marketing, securities.
- **Expectation of an IR representative:** attract capital, retain capital, restore investor confidence, have access to senior management.
- Re: Corporate Governance, IR rep must advise authorities of information determined to be inaccurate or mis-leading.
- **National Investor Relations Institute urges**
 - Complete income statement.
 - Complete balance sheet.
 - Reconcile GAAP earnings to pro-forma.
 - Management discussion and analysis.

Common Stockholders – Legal Rights & Privileges

- Control of Company: Stockholders elect directors who select management. Election of directors subject to state and federal regulations.
- Cumulative Voting: Governs number of votes per share of common stock.
- Proxy: Assigning stockholder's right to vote to another individual.
- Staggered Election of Directors: Prevents rapid turnover of directors.
- Pre-Emptive Right: Shareholders' first rights of pro-rata purchase of new stock. Done through a Rights Offering or Subscription.

Expensing of Stock Options

- Treatment of stock options a key issue.
- How to give a realistic picture of company balanced against use of stock options as an incentive?
- Should stock options be treated as an expense?
- Need for one consistent approach.
- Treatment as an expense would bring U.S. and International account standards closer together.
- Some companies voluntarily show as an expense, while others show costs in footnotes.

Pension Fund Management

- Becoming more important for Treasury due to “flattening.” Treasurer responsible for management or oversight.
- Employee Retirement Income Security Act -1974 Federal law. Legal guidelines for a plan administration and investment.
- **Major Objectives:**
 - Ensure stakeholders receive adequate information.
 - Standards of conduct for those who manage plans.
 - Adequate funds set aside to pay promised benefits.
 - Employees must meet minimum requirements to receive benefits.
 - Safeguard benefits when plans are terminated.
- Sets standards for plans to receive favorable tax treatment and avoid penalties.
- Plan must be funded with contributions placed in separate fund.
- Third-party Trustee or insurance company holds the fund.

ERISA Regulations

- **Jointly enforced by IRS and Department of Labor.**
 - Title I: Employee rights.
 - Title II: Requirements for tax deferral/provisions.
 - Title III: Administration and enforcement.
 - Title IV: Defined benefit retirement plans.
- **Fiduciary Responsibilities** (Standards defined in Section 404).
 - Benefits to participants and beneficiaries.
 - Defraying reasonable expenses.
 - Prudent Man

ERISA

- **Defines:** Prohibited transactions – economic transaction involving plan assets and “party-in-interest.” Certain transactions are exempted. (Sanctions on Fiduciaries).
- **Impact on Corporate Governance:**
 - Proxy voting must be done solely in the plan participants’ interest.
 - Proxy decisions made by plan sponsor, unless delegated to investment manager. Sponsor cannot interfere with investment manager’s decisions.
- **Reporting and Disclosure Requirements:**
 - *Filings must be made with:*
 - IRS – Form 5500.
 - Department of Labor – Summary Plan Description.
 - Pension Benefit Guaranty Corporation – Quarterly and annual reports.
 - Plan Participants – receive Summary Plan Description and annual financial statement summaries.

ERISA

■ **Nondiscrimination Rule:**

- Plan cannot discriminate in favor of Highly Compensated Employees – those with a 5% ownership of sponsoring company, or compensation in excess of \$90,000.
- Minimum Coverage Requirements, in order to receive favorable tax treatment.
- Ratio–Percentage Test: Percentage on non-HCE's = 70% of HCE's.
- Average–Benefits Test: Benefits to non-HCE's at least 70% of benefits to HCE's.

Erisa

- **Plan Termination:**

- PBGC oversees plan termination.

- Distress Termination: PBGC takes over plan.

PBGC pays benefits.

Plan sponsor liable for under funding.

- Standard Termination:
purchase of

Benefits funded through

annuities or lump sum payments.

Administrator to give 60 days'
notice to participants and PBGC.

Subject to approval by PBGC.

Pension Plans

FORMATS:

- Single – Employer: Established and maintained by corporates or not-for-profits for employees.
- Multi-Employer: Subject to collective bargaining agreements between unions and more than one employer.

TYPES:

- Defined Benefit Plan: Benefit payments are defined by a formula based on factors such as pay level and length of service.
 - Obligation = Plan's liability.
 - Obligation funded by employer contributions and cumulative earnings.
 - Plan's asset value compared to obligation can result in Overfunding or Underfunding.

Pension Plans

- Defined Contribution Plan: Retirement savings vehicle.
 - Benefits defined by contributions to the plan and earnings.
 - Individual account for each participant.
 - Participant makes investment decisions.
 - 401(k) or 403(b)

Defined Benefit vs. Defined Contribution

- **Main difference** – who takes investment return risk.
 - Defined Benefit – employer bears risk.
 - Defined Contribution – employee bears risk.
- **If a short fall:**

Defined Benefit – employers must make contributions to make up the shortfall. (If excess investment earnings, employee does not receive excess.)

 - Defined Contribution – employee must accept shortfall. (But, employee keeps any excess.)
- **Other differences:**

In early years, Defined Benefit values grow slower than Defined Contributions.

Portability – Depends on type and vesting.

 - Vesting = when employee can legally claim benefits.
 - Defined Contribution: existing asset balances and employer contributions (subject to vesting) more easily portable.
 - Defined Benefit: Portability subject to plan design.

Plan Risks - Participants

Defined Contribution Plans: Participant – Directed.

- Participants decided how assets are invested. Therefore, participants responsible for consequences and investments risks.
- Mortality Risk: The risk that participant will outlive benefits and that retirement benefits will be insufficient because of:
 - Not setting aside enough current income.
 - Adverse markets
 - Investment choices are limited.
 - Poor investment selection.
 - Changing personal circumstances.

Defined Benefit Plans: Employer responsible for investment and mortality risk.

- PBGC additional security.
 - Slight chance it will not cover 100%
- Higher paid employees might have some corporate credit risk.

Plan Risks - Employer

- Defined Contribution Plans: Employer's expense aligned with contributions.
- Defined Benefit Plans: Employer expenses/contributions affected by:
 - Current interest rates.
 - Actuarial assumptions.
 - Investment performance.
- Defined Contribution Plans:
 - Employer contributions tied to employee contributions and company profitability.
 - Investment and mortality risks are transferred to the participants.
- Defined Benefit Plans:
 - Employer contributions can be reduced if asset value is greater than promised payments.

Deferred Compensation and Non-Qualified Plans

- Under a Qualified Plan, employees and the employer can experience tax benefits. (Ex.) Pension Plan. Profit Sharing Plan.
- To qualify, must meet requirements of Internal Revenue Code, section 401(a):
 - Broad-based employee participation.
 - Limits on deferred income amounts.
 - Plan cannot discriminate in favor of certain employees.
- Non-Qualified Plans: Eliminate above requirements but without tax benefits.
 - Company can choose employees to participate.
 - Employee can defer tax on income, but employer cannot benefit from tax deduction.

Types of Plans.

- 401(k)
 - Employee given choice of receiving current taxable income or deferring taxable amount to a future date.
 - Employee may divert portion of compensation to the 401(k) on a pre-tax basis.
 - Employer can make additional contribution to the plan, usually based on a matching formula.
- 403(b) or Tax – Deferred Annuities:
 - Generally available to employees of Not-For-Profits.
 - Only employees make contributions, on a pre-tax basis.
 - No employer contributions.
 - Limits on amount employee can contribute.
 - Employees have right to borrow money from plans.
 - Employees can withdraw funds before 59 ½ to fund certain emergencies.

Current Developments

- **Hybrid Plans** - blends of Defined Benefit plans and Defined Contribution plans.
- **Cash Balance Plans** – Portable.
Reports balances similar to Defined Contribution plans.
“Career average” calculation of payment.
Actually a Defined Benefit Plan.
- **Pension Equity Plans (a/k/a Retirement Bonus Plans)** –
Reports balances similar to Defined Contribution plans.
“Final pay” calculation based on final compensation, participant’s age and/or years of service.
- **Floor Plans** – Two coordinated plans: one Defined Benefit and the other Defined Contribution.
Defined Benefit sets a floor retirement payment.
Defined Contribution investments determine payments.
Benefit plan funds
If value below the floor, Defined the gap.

Advantages of Hybrids

If employer wants to change from a Defined Benefit plan to a Defined Contribution plan, hybrids may be a good alternative.

- Good choice when Defined Benefit plan is overfunded.
- Surplus assets can pre-fund employer.
- Employer can control investment decisions.
- Employer can offer plan with characteristics similar to Defined Contribution plan.
 - Account Balances
 - Portability.

Pension Management – Other Considerations

- **Establishing a Pension Committee:**
 - Needed with Defined Benefit plans.
 - Formed to manage plan and advise company's senior management.
- **Managing the Investment Managers:**
 - Companies want an Investment Manager who will work to:
 - 1.) Establish objectives/risk tolerance.
 - 2.) Allocate assets.
 - 3.) Select investment mix.
 - 4.) Monitor portfolio's progress.
 - Company must choose and then review Investment Manager's performance.
- **Understanding Tax Implications:**
 - In ERISA-qualified plans:

Funds contributed by employees and employers can accumulate on tax-deferred basis.
 - In Defined Contribution plans:

Employee contributions are tax-exempt.
Employer contributions are tax-deductible.

Pension Management – Other Considerations

- **Appointing a Custodian:**

- Good safeguard of the pension fund assets.
- Custodian holds fund assets.
- Additional services can include:
 - 1.) Securities lending.
 - 2.) Cash management.
 - 3.) Investment accounting.
 - 4.) Reporting.
 - 5.) Performance measurement.

- **Education/Advice:**

- ERISA does not require investment education/advice. However, fiduciaries must give consideration to relevant facts.
- Companies can provide investment education only, without being advisors. Investment advice = potential liability.
- ERISA: Considered investment advice if:
 - 1.) Fee charged for investment recommendations.
 - 2.) Advice is primary reason for the investment decisions.
 - 3.) Advice is individualized.

The Objectives of Relationship Management

- Access to Credit
- Access to Non-Credit Banking Services
- Manage Costs and Quality of the services
- Monitor the Risks of the Financial Institution or Risks to the relationship
- Develop a Partnership with the Bank

Selecting a Bank

- Consolidation in the industry
- Specialization by banks
 - Match the specialty to your needs
- The Process
- Informal: Based on an existing relationship
- RFI: Can narrow the field or promote idea generation
- RFP: A formal document
 - Outlines a company's requirements
 - AFP and BAI have standard RFP formats
 - Beware the pitfalls

Selection of a Provider

Common Selection Criteria

- Knowledge of Industry/Business and commitment
- Responsiveness
- Understanding of company's needs
- Customer Service
- Pricing
- Providing credit or consultation
- Bank's financial strength
- Commitment to an area of business
- Relationship management/technical specialists
- Customization of services
- Development of new services
- Geography or convenience
- Meeting future needs

Relationship Management Issues

- Consider the following:
- The Bank's Creditworthiness
 - Remember CAMELS (used by the regulators)
 - Capital Adequacy
 - Asset Quality
 - Management Capability
 - Earnings
 - Liquidity
 - Sensitivity to Market Risk

Relationship Management Issues

- How many bank relationships should you have?
Depends on:
 - Access to Credit.
 - Costs. Large companies are trending to fewer relationships.
 - The Collection or Concentration System you use. Retailers often end up with many bank relationships.
 - The Banking Requirements of a Global Business.
 - How the Bank fits into your strategy.
 - Relative strengths and capabilities of each bank.
 - Services Provided.

Relationship Management Issues

- Negotiation: Important as bank's measure relationship profitability
- Pricing: Whether for loans or services, based on many interdependent factors
- Documentation:
 - Account Resolution, usually issued by Board of Directors.
 - Functions performed by individuals.
 - Limitations of Relationship.
 - Banks have their own format.
 - Companies can have their own format.
 - Whether banks accept, subject to negotiation.
 - Signature cards. Absolute requirement.
 - Terms and Conditions.
 - Service Agreements. Specific to service, can be standard or customized. Include:
 - Operational policies and procedures,
 - Performance Standards,
 - Compensation,
 - Liability,
 - Terms and conditions.

Relationship Management Issues

- Audit and Control issues that companies have to manage:
 - Account opening policies and procedures
 - Approvals required.
 - Corporate resolutions.
 - Authorized individuals to contact for services.
 - Authorized signatories.
 - Reconcile accounts and report problems on a timely basis
 - UCC Article 4: Thirty (30) days to report unauthorized activities.
 - Separation of duties.
 - Maintenance of account documentation.
 - Tracking unresolved discrepancies.

Relationship Management Issues

- Measurement and Evaluation
 - Determine your expectations.
 - Agree to service levels.
 - Measure with a Report Card:
 - Gives a quantitative rating for a bank based on service quality and responsiveness.
 - Measure with a Relationship Review:
 - Formal or informal.
 - Can include senior management.
 - Banks will do relationship reviews.

Compensation/Account Analysis

- Goal: A successful relationship based on:
 - Communication and feedback.
 - Clear expectations.
 - Fair compensation and pricing.
 - Complete disclosure of critical information.

- Account Analysis:
 - An invoice with detail on services, balances, and credit earned.
 - Terminology, format and pricing methodologies can vary.
 - AFP Account Analysis Standard.
 - AFP Service Codes. Service code families include:
 - Lockbox Services
 - Depository Services
 - Paper Disbursement Services
 - General ACH Services

Compensation/Account Analysis

- **ASC X12 822 Account Analysis Format -**
 - Developed as a standard format for account analysis statements sent electronically.
- **Terminology. Be familiar with:**
 - Service Charges
 - Earnings Credit
 - Average Ledger Balance
 - Average Deposit Float
 - Reserve Requirement Balances
 - Earnings Credit Rate
 - Commonly based on 90-day T-bill rate
 - Some banks use a reserve-adjusted ECR
 - Average Collected Balance
 - Investable Balance

Compensation/Account Analysis

Earnings Credit Calculation:

$$\text{Collected Balances} \times (1 - \text{Reserve Requirement}) \times \frac{(\text{ECR} \times \text{Days in Month})}{365}$$

Collected Balances Required:

$$\frac{\text{Monthly Service Charge}}{(\text{ECR} \times \frac{\text{Days in Month}}{365}) \times (1 - \text{Reserve Requirement})}$$

Balance Multiplier:

$$\frac{\$1}{(\text{ECR} \times \frac{\text{Days in Month}}{365}) \times (1 - \text{RR})}$$

Compensation Practices

- Excess Collected Balances:
 - Reg Q prevents interest being paid. However, some banks may allow excesses to be carried forward.
 - Deficit Service Charges:
 - Collected either via Direct Debit or Invoice.
 - Earnings Credit Calculation:
 - Application of ECR can vary among banks.
 - Compensation Basis:
 - Accounts can be individual compensation or combined compensation.
 - Consolidated Account Analysis:
 - Used by interstate banks.

Service Charge Comparisons. Software can help.

- Challenges include:
 - Pricing strategies vary among banks
 - Bundled charges or unbundled charges
 - Prices vary due to service level provided

Fees vs. Balances

- Preference can vary bank-to-bank
- Why a company may favor Fees.
 - Opportunity Cost based on investment rates, borrowing rates, reserve requirement.
 - Expense control. Can be budgeted.
- Why a Bank may favor Fees
 - Capital Requirements. Can go up as deposits are maintained.
 - Fees are a recurring source of income.

Fees vs. Balances

- Why a company may favor balances:
 - Unanticipated balances may help offset service fees.
 - Loans and other services might be priced more favorably.
 - Less visible in budgeting.
 - Some banks may charge less.
- Why a bank might favor balances:
 - Some banks want balances to fund requirements.
 - Investment returns can be enhanced.

Amegy Bank