SF bulletin

By Amanda Balbi, Stephen Barlas, Daryl Wieland

GOVERNMENT

Swaps Bill Likely to Pass Congress

By Stephen Barlas

What a difference an election makes. With Republicans taking over control of the U.S. Senate in 2015, companies concerned about the impact of the Dodd-Frank Act on the cost of hedging commercial risks will finally see Congress pass legislation to clarify a key section of the Act. That law, and its subsequent interpretation by federal regulation writers, seems to give banks that serve as swap dealers more leeway than currently is the case to collect margin from nonfinancial companies, for example, an airline company that hedges the risk on fuel costs or a breakfast cereal company that hedges the cost of corn.

The House passed H.R. 634, Business Risk Mitigation and Price Stabilization Act, in August 2013 by a nearly unanimous vote, saying any final rule written by any federal agency should make it clear that the Dodd-Frank provision means that banks can, if risk dictates it, collect margin from nonfinancial companies. That is the current situation.

The Senate version of that bill (S. 888) never came up for a vote despite significant Democratic support there. That was because Senate Majority Leader Harry Reid (D.-Nev.) refused to bring it up for a vote. New Majority Leader Mitch McConnell (R.-Ky.) will have no such hesitation.

But Congressional passage of the bill won't end the discussion. Three separate federal agencies have been struggling to write three separate rules defining when swap dealers must obtain margin—and of what type—from nonfinancial companies purchasing derivatives that haven't been "cleared." The Federal Reserve Bank and other bank regulatory agencies, referred to as the Prudential Regulators, are supposed to regulate swap dealers (SDs) and major swap participants (MSPs) that are banks. The Commodity Futures Trading Commission (CFTC) regulates SDs and MSPs that aren't banks. And the Securities & Exchange Commission (SEC) regulates security dealers. All three have published proposed rules and will issue final rules.

Approximately 80% of noncleared swaps will be subject to the banking agencies' margin rules once they're finalized. In September 2014, the Prudential Regulators

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issued a new proposed rule on SDs and MSPs, making changes from a proposed rule they issued in 2011. The changes were made to quiet business community concerns about the collection of margin, which can be a major cost for a corporation. The new proposal essentially follows the Congressional Business Risk Mitigation bill in general terms. In a press release, the Prudential Regulators say, "The proposed rule does not require a covered swap entity to collect specific or minimum amounts of initial margin or variation margin from nonfinancial end users, but rather leaves that decision to the covered swap entity, consistent with its overall credit risk management." Again, that is how things stand today, Dodd-Frank notwithstanding.

Despite that positive affirmation of the status quo, the new proposal delves into some items of technical minutia that aren't covered by the Business Risk bill and gives considerable pause to groups that are part of the Coalition of Derivative End-Users. In a November 24, 2014, letter, the Coalition wrote, "Certain areas in the Proposal require clarification and further consideration in order to ensure that the final rule will effectively regulate the derivatives markets without imposing undue burdens on derivatives end-users." One concern is how the Prudential Regulators define financial end users, who will have to post margin. The definition in the new proposal could be read to include central treasury units at commercial corporations. Another concern relates to whether the proposal's definition of "material swap exposure"—again triggering a margin requirement—should apply to corporate pension plans.

Advisory Committee Recommends More Corporate Information on Drug Plan Costs

A report due out this month from a Department of Labor federal advisory panel is expected to give a boost to the decade-long effort by corporate employee health plans to get more pricing information from pharmacy benefit managers (PBMs). Companies have complained that they can't audit PBM pricing arrangements with drug manufacturers and pharmacies to determine whether the company is getting the financial benefits—often its share of rebates—the contract calls for.

The Department of Labor's ERISA (Employee Retirement Income Security Act) Advisory Committee approved two recommendations in late September 2014 recommending that the Department require disclosure of direct and indirect compensation, such as rebates obtained by the PBM. The Department of Labor could use the report to jump-start a new regulatory proceeding that it initiated a decade ago and then discontinued. Michael Trupo, a Department of Labor spokesperson, says, "In the past, some council recommendations have led to regulatory projects. The Department looks forward to reviewing the council's final reports when they are submitted."

Allison Klausner, assistant general counsel—benefits at Honeywell International Inc., says, "I think it has become abundantly clear that developing appropriate regulations regarding PBM disclosure could support parties as they strive to enter into or modify existing contractual relationships that are compliant with ERISA."

Discussing Cyber Security at the Board Level

By Amanda Balbi

The recent cyberattack on Sony Corporation is yet another example of the potentially devastating consequences that companies face with a data security breach. Companies of every size are vulnerable, and information technology (IT) and other data security risks are an increasing concern among investors. But a recent report from PricewaterhouseCoopers (PwC) reveals a gap between investor views on the importance of cyber security issues and the percentage of boards that discuss them.

continued on page 24

Sharing Your IMA Life

Most IMA® members share a strong spirit of camaraderie. What have your experiences as a member of IMA been like? Do you have a story about them you'd like to share? If so, please consider writing an IMA Life column that will be published in *Strategic Finance*. You can be a student member, a young professional, in the midst of your career, or retired. If you would like to write an IMA Life article, please e-mail Kathy Williams at kwilliams@imanet.org.

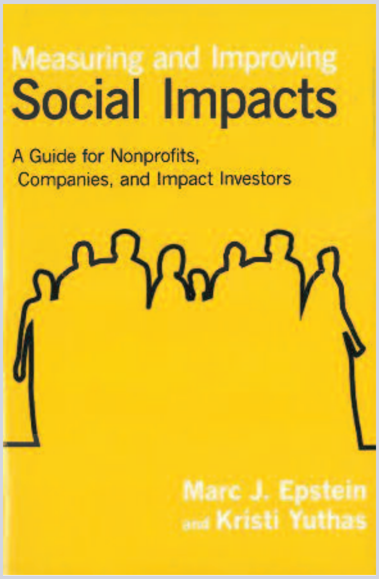
BOOKS

Manage Social Impact

If you read the cover story of last month's *Strategic Finance*, "How to Create a Real Social Impact" by Marc J. Epstein and Kristi Yuthas, you learned about the five most important questions to ask when tracking and measuring social impact. In their book, *Measuring and Improving Social Impacts: A Guide for Nonprofits, Companies, and Impact Investors*, which was the foundation of that article, Epstein and Yuthas delve into greater detail to explain the Social Impact Creation Cycle and how companies can evaluate the results of their social efforts.

Begin by following the Impact Measurement Roadmap. Prepare the measurement foundation by defining both the positive and negative impacts you expect to result. Some results—such as increasing female empowerment—are difficult to assess, so make sure your measures are actionable, manageable, and comparable. Then consider how you will use the results and identify key impacts and metrics. From that information, you can develop a measurement system.

Next, write an investment mission statement. This statement describes the social or environmental changes your company will address, defines the capabilities and resources your company plans to use to solve the problem, identifies the specific region or population you'll target, and explains the methods you plan to use to achieve your goals.



When stating your goals, think about the reason behind your actions and not just the output.

For example, American Express gets most of its revenue from travel expenses. So to encourage and improve tourism, it funds Travel and Tourism Academies that educate people interested in working in travel agencies, airlines, hotels, and restaurants.

Epstein and Yuthas discuss Theories of Change, which are diagrams that link actions to impacts. These can help you determine your goals and identify the change you want to create. When stating your goals, think about the reason behind your actions and not just the output. For example, a company might deliver bed nets to malaria-stricken locations. The output is the bed nets, but the goal of the action is to reduce the spread of malaria.

After the mission statement is complete, develop a theory that explains what you plan to do to achieve your goals. Validate the theory by comparing it to those of peers working in similar fields. What worked for them? How can you improve their strategy?

Finally, create a measurement system based on company goals. Data needs to be gathered for each metric, and the results need to be evaluated against the initial strategy. Don't hesitate to start over and create new goals and strategies based on the results. Epstein and Yuthas suggest continuously monitoring these metrics and producing annual sustainability reports. They note, "Ninety-five percent of the world's largest 250 corporations now track and report publicly on the social impacts they create."

Companies looking to become more socially responsible and environmentally friendly will find this book to be an excellent guide for implementing efforts and measuring meaningful impact. With a checklist after each chapter to help you along the path to success, the book will have valuable, useful advice whether your company is just starting to become aware of its social impact or has already begun its journey.

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SFbulletin

Continued from page 22

Released in December, "What matters in the boardroom? Director and investor views on trends shaping governance and the board of the future" compares the findings of *PwC's 2014 Annual Corporate Directors Survey* with *PwC's 2014 Investor Survey*. The results show that 84% of investors believe company boards should discuss cyber security issues, but only 57% of directors report having discussions. A similar gap is found when asked about privacy risk. About 90% of investors think boards should be involved with privacy risk discussions, but only 64% of directors report discussions.

In addition, almost 75% of investors believe it is important for corporate boards to discuss a company's crisis response plan for a major security breach, but only 52% of directors report having discussed such a plan.

There's also a difference when it comes to consulting with outside experts or keeping current on cyber security issues. The PwC report suggests that directors' low prioritization of this issue might mean they aren't fully aware of the standards or the increasing risk. Only 42% of directors reported having discussions about engaging an outside expert, but 68% of investors think it's important. Both groups were also asked about the Department of Homeland Security and National Institute of Standards and Technology's *Framework for Improving Critical Infrastructure Cybersecurity*. Only 21% of directors reported discussing the Framework, but 45% of investors think it's important.

The Framework promotes infrastructure protection by creating a connection between business drivers and cyber security activities. It considers cyber security risks to be part of the company's risk management process, which both directors and investors in PwC's surveys agree is a top priority.

The Framework doesn't outline additional requirements that companies must meet; rather, it lists best practices and guidance for preventing data breaches. To encourage use of the Framework and support companies' cyber security efforts, the Critical Infrastructure Cyber Community (C^3) Voluntary Program was established for any company that wants to use the Framework but lacks the resources to implement it. For more information on the Cybersecurity Framework and the C^3 Voluntary Program, visit www.dhs.gov/using-cybersecurity-framework.

The PwC report shows the discrepancy between the relevance of these issues and how much boards are currently addressing it. Even directors recognize the increasing importance. Directors rank IT risks, including cyber security, as No. 2 on their list of priorities, and 65% want to spend more time discussing these types of risks.

As more companies realize the risk and consequences of data breaches, more enthusiastic discussions should be had at the board level to ensure proper procedures are in place. It's also important for companies to constantly update their guidelines according to current standards and to ensure they are fully aware of the potential dangers.

To view PwC's full report, which also addresses board composition, director communication, executive compensation, and more, visit www.pwc.com/en_US/us/corporate-governance/publications/assets/pwc-what-matters-in-the-boardroom-director-investor-views.pdf. **SF**

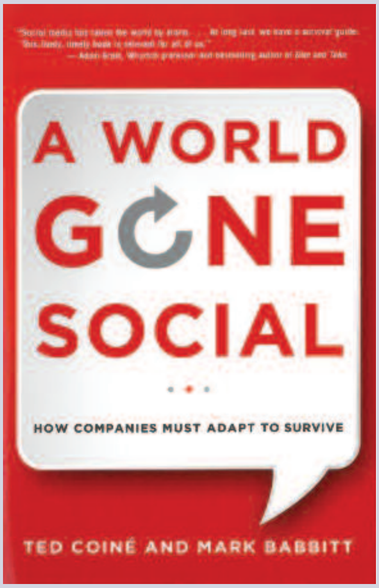
BOOKS

Embracing Social Media

Social media is not a flash in the pan. In *A World Gone Social: How Companies Must Adapt to Survive*, Ted Coiné and Mark Babbitt make a compelling argument that it has become "a strategic inflection point." The Industrial Age is over, and the authors say we're now in the Social Age. Yet many of our organizational structures and business models remain unchanged. Coiné and Babbitt urge you to be a change agent for your organization rather than sitting by while other organizations blaze a path on social media.

They argue that social media allows people to strengthen their relationships with others. Companies have annual employee engagement surveys and client satisfaction surveys, but social interaction is different. Social is real-time communication. When done well, social media fortifies our engagement with the customer. When done poorly, social media can focus the wrath and disappointment of customers. For example, when United Airlines mishandled a customer's guitar in 2008, the customer wrote a protest song and uploaded it to YouTube. Within one day, the video received 150,000 views, prompting United Airlines to issue an apology.

The idea that trust takes years to build has been flipped on its head. Trust can be built in a manner of minutes by solving a customer's problem. Then the magic of the network effect takes over. Customers tell people in their network how well they were treated and then strongly recommend your company. These unsolicited customer testimonials are more powerful than any advertisement your company can buy. Yet unresponsive behavior can still break trust with one mishandled situation. Social media is a powerful tool that cuts both ways.



When done poorly, social media can focus the wrath and disappointment of customers.

The authors pepper much of the book with change management insights that will help most organizations make their culture more conducive to social strategies. This isn't a "how to" book, but Coiné and Babbitt provide a lot of insight as to what has worked well for companies and what hasn't. A good example is their discussion of the three basic rules of social media: (1) actively listen, (2) respond quickly, and (3) meet customers where they are now.

After reading the book, you'll be compelled to test your organization against the 10 questions provided in chapter 11 to see if your organization is ready for what they call an Ordinary People Extraordinary Network (OPEN), which is when ordinary people broadcast their experience with your brand to others. One of the most telling questions for me was #8: What is our CEO's social media presence? Is it really the voice and opinions of your CEO, or is it written by the public relations team? In a 2012 study by BRANDfog, 82% of respondents said they trust a brand more that has a CEO who is active on social media.

While the accountant in us wants to know the return on investment (ROI) of social media, we need to take the long-term view of this and think of it as an investment, just as we do with our marketing expenses. Coiné and Babbitt capture it best by asking, "What's the ROI on still being in business 10 years from now?" I strongly recommend reading this book to get a glimpse of the future of business and to learn how your company can leverage its social media accounts.

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