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Cyber risk: the treasurer's role

How should you be managing cyber risk?

The Corporate View

Anthony Buchanan
Head of Treasury
Asahi Europe

Money market funds: whats new?

From the prospect of further regulatory reform to the rise of ESG considerations in investing, what does the future hold for money market funds?

Cash Management

Cash management technology: time for real-time at last?

Funding

Treasury's challenge: environmental performance and financial reporting

Question Answered

Treasury's preference: remote, hybrid or in-office?

Back to Basics

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Treasury's climate challenge

The latest message from the Intergovernmental Panel on Climate Change, released in August, was a dire warning from scientists on the impact of climate change. It has focused attention on the UN's COP26 conference in November and the urgency to get gathered countries that have adopted the Paris Agreement to collaborate on cutting emissions to sign up to new, tougher cuts in Glasgow to try and decarbonise the world.

As the politicians get ready to wrangle, this edition explores one growing treasury's role in helping companies meet the challenges of climate change. Corporations are setting increasingly bold environmental goals, yet these promises are rarely mirrored in their financial statements, making it difficult for investors and other stakeholders to see the relationship between a company's financial and sustainability performance.

New financial reporting standards due to be unveiled at COP26 aim to change this, laying out how companies should report to give as clear a view of corporate sustainability as they currently do financial performance in one, integrated report. Moreover, the different and acronym-heavy measurements and reporting standards surrounding ESG will be replaced with a standard norm. Going forward, treasury and finance will play a growing role, with sustainability teams incorporating these new standards and understanding how changes in corporate strategy and the impact of regulation will translate into the figures they use to prepare their financial statements.

Our Corporate View with Anthony Buchanan, Head of Treasury at Japanese brewer Asahi Europe, illustrates where else treasury can lead on sustainability, like the brewer's working capital support of a supplier wanting to finance a factory closer to an Asahi brewery to cut logistics costs. Elsewhere, his treasury has signed a ten-year electricity contract in Poland, wholly tied to wind in an offtake deal that helped the renewables farm finance its infrastructure build.

This edition also explores how companies can minimise FX volatility in current market conditions and the frequency with which they should review their hedging strategy. We also take a long look at the latest cyber threats in the wake of the pandemic, and ask a group of experts what impact long-term working trends hold for treasury.

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IN THIS ISSUE

INSIGHT & ANALYSIS 4

Building resilience against the cyber threat

The pandemic has exacerbated the challenges around cybercrime, from new scams to the challenges brought by remote and hybrid working arrangements. What's more, the treasurer's role in managing cyber risk is not always clear – so what should treasurers be doing?

CASH MANAGEMENT 8

Cash management gets real

Real-time cash and liquidity management has been on the agenda for many years. With the COVID-19 pandemic changing consumer and business behaviour, the time may now be right for a real-time revolution.

SMARTER TREASURY 10

SCF in China: harnessing technology

Taulia's Steve Scott and Haiyan Zhuang talk about opportunities in China's SCF market, the role technology is playing in driving progress, and how companies are using SCF to improve the resilience of their supply chains.

FUNDING 12

Treasury's challenge: environmental performance and financial reporting

As investors increasingly clamour to see the relationship between a company's financial and sustainability performance, so treasury and finance teams will play an increasing role in integrating sustainability into financial reporting.

BACK TO BASICS 20

Don't be afraid to look through the hedge

The significant cost of currency fluctuation demands better understanding of how unfavourable movements can impact the bottom line.

TREASURY ESSENTIALS

Treasury Insights	7 & 27
Question Answered	23
Market View	25

15 The Corporate View

Anthony Buchanan
Head of Treasury Operations

Anthony Buchanan, Head of Treasury for Asahi's European and international treasury operations, describes a thrilling role at the heart of both the business and the financial markets.

INVESTING 18

Money market funds: what's new?

From the prospect of further regulatory reform to the rise of ESG considerations in investing, what does the future hold for money market funds?

Building resilience against the cyber threat

Cyber risks have been exacerbated by the pandemic, while criminals continue to become more sophisticated. But it's not always clear what role treasurers should play in managing this type of risk. So what should treasurers be doing to protect their organisations from cybercrime?

There's no question that cyber risk remains a major threat to organisations. And it's also clear that the disruption brought by the COVID-19 crisis has exacerbated the risks: 81% of executives polled in the EY Global Information Security Survey said that the pandemic had forced their organisations to bypass cyber-security processes.

As cyber-criminals become increasingly sophisticated, the cyber threat continues to grow. However, it is not always clear what responsibility treasurers have for managing this type of risk. So what are the most significant cyber threats companies are facing today – and what measures can treasurers take to protect their organisations effectively?

Understanding the latest threats

Cybercriminals continue to be adept at evolving rapidly and exploiting new vulnerabilities when they arise, so it's important to understand the latest threats. Here are some of the latest threats and trends.

When ransomware meets extortion

While ransomware continues to be a problem, the threat has been exacerbated by criminals who are combining it with extortion, explains Joseph Krull, a Senior Analyst at Aite-Novarica Group who specialises in cybersecurity, privacy and IT risk. "What they'll do is steal data – and then they'll lock the computers and threaten the company that if they don't pay the ransom, they will make public the data they have stolen," he says. In addition, he says, ransomware organisations have become increasingly sophisticated: "Instead of doing the attacks themselves, they've licensed their tools to others through an affiliate programme – and then they take a share of the ransoms as payment."

As Bank of America's Cyber Security Journal notes, "There's a very simple reason that ransomware is proliferating so fast: it often works, because victims face a ticking clock and severe impacts on business operations. For businesses of all sizes, the integrity of and access to data is crucial to operations, and many fear the negative impacts on brand and reputation should a data breach become public."

What's more, says Krull, when cyber-criminals break into an organisation, they will look for key data, such as whether the company has cyber insurance, and how much the payoff would be in the event of a breach. "So when they ask for a ransom, they already know what a company can afford." In addition, he says, insurance providers are increasingly taking on the role of negotiating ransom on behalf of their clients in order to reduce the size of the pay out.

However, paying the ransom has the potential to create a different set of problems. "The US Treasury Department has said that if they can prove you have made payments to anyone that's on the economic sanctions list, you can be subject to penalties," says Krull. "So the Treasury is now examining who people are paying ransoms to, and if companies are paying someone on that list they are going to face additional sanctions, or even hold the executives responsible."

Supply chain attacks

Also of concern is the risk of a supply chain attack – such as the high-profile SolarWinds attack, in which malicious code was added to the company's network management product. Consequently, 18,000 of the company's clients became vulnerable to attack after installing software updates, with victims including the Pentagon, Microsoft and the US Treasury Department.

More recently, IT solutions developer Kaseya was the victim of a supply chain ransomware attack, in which managed service providers (MSPs) using the software were targeted, together with their clients. In total, as many as 1,500 organisations

around the world were affected by the attack. As Krull notes, "What we learned was that the supply chain is still going to be under attack, and will be used as a way to find the path of least resistance into an organisation."

COVID-related scams and the rise of remote working

As the pandemic escalated in 2020, fraudsters quickly began exploiting the crisis with new scams – including malicious domains exploiting people searching for information about the pandemic. Other examples included PPE-related scams, as well as instances of criminals posing as contact tracers and asking victims for their identity information and credit card details.

More recently, Krull says there has been a move away from COVID-related scams. "Frankly, people are becoming much more suspicious about these things. But there have been some really clever campaigns – such as using well-crafted messages that look like a DocuSign message to get people to download malware."

Another impact of the pandemic is the rise of remote working – and, more recently, hybrid working arrangements. "There are people coming into the office, and those that either refuse to come into the office or have got used to working remotely and have asked their employers for an exception for returning to the office," says Krull. "So now organisations have to provide defences for both onsite and remote workers, which becomes a bit complicated."

Where treasury is concerned, many companies have adapted smoothly to the different working conditions adopted in response to the pandemic. Paul Bramwell, Principal & Founder at Treasury Tech Advisory, notes that the move to working from home has worked remarkably well, with the vast majority of companies having technology in place to facilitate remote working. "Effectively, companies enacted their business continuity plan, which became more of a BAU operating model," he observes. "Companies have evolved to the new normal by ensuring they have strengthened their IT and data security configurations to ensure remote workers only use a firm's own VPN, that all multi-factor options are enabled, and increased use of IP whitelisting."

As Bramwell points out, companies that had already moved to a modern treasury and payment platform ahead of the pandemic were better placed than those that hadn't, "and were already in a great place to have staff working from home."

"From my perspective, COVID has simply acted to shine a light on the importance of good treasury processes, underpinned by good treasury systems," adds Carl Sharman, Head of Treasury Technology Advisory at Deloitte. "When it comes to security, there should be no difference between logging on and making transactions from your office, your home, or anywhere else on the planet."

Zero trust

As the threats continue to evolve, another notable development in the world of cybersecurity is the increasing focus on the concept of zero trust. "More and more organisations have embraced cloud computing," explains Krull. "The idea is that instead of having to go through a firewall or a VPN, they'll go straight to the data and authenticate themselves to every data source, application or asset that they want to interact with. It's a much simpler way of doing it – but it's a real challenge for a Chief Information Security Officer to build that kind of infrastructure."

Building resilience

So what should companies be doing to protect themselves from the cyber threat in today's landscape? "If I were a Chief Information Security Officer right now, I would probably go back to basics and review how many of the tools I'm currently paying maintenance fees for are still effective," says Krull. "For any that aren't, I would get rid of them and replace them with something more modern.

"I would probably look for additional automation, so that I don't need a lot of people to do things manually. I would look at reducing the number of third parties that can come into the network. And if I bought custom software, I would check it extensively before allowing it to be on the network."

He adds that while these measures aren't enough to prevent a company from being breached, they can make it that much harder for an attacker to get in. "As others have said, the organisation has to be right 100% of the time – but the attacker only needs to be right once to be able to breach the organisation. It's all about resilience today: how can I limit the impact? And how quickly can I restore business operations?"

Securing the treasury

For treasurers, Bramwell highlights the importance of having a clearly understood and documented manual that is regularly updated and tested. "This should be done alongside internal (and even external) auditors to make sure any potential risks from fraud or cyber threat are effectively stymied," he says. "Compensating controls can be put in place in the event of system deficiencies, but it is paramount that everything is thoroughly tested."

In addition, he points out treasurers may face challenges when it comes to making sure staff do not circumvent internal policies and procedures – for example, by writing passwords in 'hidden' places, such as the bottom of the laptop. "Security controls such as dual factor and tokens (both virtual and physical) also seem burdensome, and appear to make operations clunky," he adds. "A treasurer needs to make sure all staff are aware of why such controls exist, and why they absolutely cannot be circumvented."

Addressing technology risks

It's also important to understand the implications of cyber threats for the treasury's technology infrastructure. As Bramwell explains, "Technology vendors are acutely aware of the threats and risks, and routinely test their environments and software for vulnerabilities that could be exploited by groups with nefarious intentions. Threats are often controllable within the treasurer's team, but oftentimes remain under the control of the organisation's technology team and the vendor."

Where vendors are concerned, Bramwell notes that treasurers are increasingly outsourcing a significant component of potential cyber issues to their vendors. "The best vendors will produce regular documentation,

unqualified and timely, demonstrating the security of their systems, process and hosting environments," he says. "These are performed by third parties specialising in cyber security, processes and controls, and provide a significant level of comfort that moving to SaaS/cloud does not expose your company to undue levels of risk.''

As such, Bramwell says treasurers need to ensure their solution vendors go through regular testing for their own controls. "These morphed over the years from SAS70 to SSAE audit resulting in SOC certifications. This cannot be overstated – any qualifications to SOC reports should be taken very seriously," he says.

Choosing the right solution

Deloitte's Sharman argues that treasury should be employed as part of an end-to-end process, as a facilitator for good practice, rather than as a solution itself. "However, treasurers should determine how their organisation needs to operate before selecting the technology that is the best fit and adopting its capabilities – there will still be design elements and rules of the road for employee engagement," he says. "Security, user experience and quality of output – not cost – should be the core decision drivers."

Who's responsible

A further obstacle when it comes to managing cyber risk is that the responsibilities of the treasury are not always straightforward. "I think the challenge is that for many treasurers, it isn't clear where responsibility for fraudulent payments actually lies," says David Stebbings, Director, Head of Treasury Advisory at PwC.

Corporate attitudes towards responsibility for cybersecurity could change in the future, however. In the UK, measures set out in a consultation by the Department for Business, Energy and Industrial Strategy (BEIS) earlier this year could result in directors having to attest to the effectiveness of their controls. The proposed measures, which have been compared to the US Sarbanes-Oxley Act, could change the way in which treasures think about operational risk in the future.

The way forward

Cyber-criminals are nothing if not opportunistic. It's essential that companies continuously work to protect themselves from cyber-attacks – and, just as importantly, have a plan in place to recover from any attacks that do take place. And while cyber-security is not always seen as a core responsibility for the treasurer, this could change in the future – so treasurers should make sure they are prepared. ■

CASE STUDY

The importance of being vigilant

George Dessing, SVP Treasury & Risk at Wolters Kluwer, says cyber-security "is top of mind for our customers, who rely on us to deliver our platforms and services safely and reliably, while safeguarding their data. We are committed to cyber-security and resilience, with our customers' success at the centre of everything we do."

Dessing adds that treasurers have an important role to play when it comes to managing cyber-security risks and maintaining related resiliency. "Hackers and other criminals are taking advantage of the current worldwide volatile situation, and their fraud schemes are increasingly more sophisticated," he says. "We remind all employees on a regular basis who are involved in any type of financial transactions, that we need to remain extra vigilant with communications received during this time of crisis – whether by text, phone or email."

Dessing adds that fraudsters that carry out 'engineering' of the company can put together names and titles, and are able to make requests look genuine. "So, we ask everybody – 'be vigilant, develop sharp reflexes and use common sense'."

In addition, he says wolters kluwer has adopted the national institute of standards and technology cyber security framework (nist-csf) "to expand the maturity-based model of our cybersecurity programme into a risk-based model."

This includes:

- **Identification** – such as guiding risk management strategy and participating in related governance structures internally.
- **Protection** – eg holding regular training and anti-fraud 'lunch and learn' sessions to encourage shared stories about the latest attempts, and ask whether home offices are cyber secure. "As a result, we implemented a mobile device management solution to protect our mobile devices, and are actively implementing multi factor authentication," says dessing.
- **Detection** – examples include technical and human controls including segregation of duties, as well as common sense checks such as call-back procedures to detect potential fraud early. Risk-based internal audits and fraud assessment activities are also used to mitigate risk.
- **Response** – "irrespective of incident type, it is important to carefully assess, track, recover and improve from financial impacts, not if but when incidents occur," says dessing. "Employees (and our vendors) are encouraged to 'pause for cause' and report suspected activities including fraud via appropriate channels."

Dessing says forward-thinking treasurers have a part to play in weaving anti-fraud protections into vendor management, payment card and banking practices. "To guard against fraud and cyber risks, it is not enough to have procedures, tools and controls," he adds. "It is very important to keep your employees informed and trained so they can detect and counter fraud attempts and cyberattacks. As we know, in almost all cases fraudsters take advantage of human weakness."

PROPOSED UK AUDIT RULES
COULD SHARPEN FOCUS ON OPERATIONAL RISK

Treasurers may not always see cyber risk as a key focus – but new rules recently proposed in the UK, which bear some similarities to the US Sarbanes-Oxley regime, could lead to a step change in the way controls are designed, implemented and embedded.

Cyber risk continues to be a major concern for organisations, not least because criminal activity has increased during the pandemic. A report by INTERPOL in August 2020 noted that cyber-criminals were shifting their targets from individuals and small businesses to major corporations, governments and critical infrastructure – and with the rise of remote working, "criminals are taking advantage of the increased security vulnerabilities arising from remote working to steal data, generate profits and cause disruption." But where corporate treasurers are concerned, it is not always clear who within the organisation is responsible for managing cyber risk. And this, in turn, can mean that it is not always seen as a top priority.

David Stebbings, Director, Head of Treasury Advisory at PwC, says the firm's 2021 Global Treasury Benchmark report will show that whilst cyber risk is a concern in general for treasury respondents, CEOs and CFOs regard cyber risk as a much more pressing issue. "That's probably because they're looking at slightly different things," he says. "Whereas CEOs are concerned about broader risks including risks to customer data, treasurers are specifically looking at payments."

He adds: "In addition, I think the challenge is that for many treasurers, it isn't clear where responsibility for fraudulent payments actually lies. Commercial payments may not be the day-to-day responsibility of the treasurer, although high value payments almost certainly will be – and what is the role of the internal IT team who manage the underlying systems? Additionally, many treasury technology tools are now hosted by vendors and the treasurer may feel they have passed on certain responsibilities to the third party, although in practice it is doubtful as to how much risk they actually accept."

Another issue, says Stebbings, is that cybercrime may only move to a top priority when there are fresh memories of a recent high profile fraud attack – such as the 2016 Bank of Bangladesh incident, in which hackers stole US$81m and came close to obtaining US$1bn. "Some people perhaps do not focus on this risk until something happens," Stebbings adds.

Attesting to controls

Moving forward, however, the prospect of new regulation could mean that treasurers need to become more focused on cyber risk and their control environment more generally. The recent BEIS consultation on corporate governance and audit reform sets out the need for a strengthened internal controls regime in the UK, and it is looking likely that the directors will be required to make an explicit public statement on the effectiveness of their organisation's Internal Control over Financial Reporting (ICFR) from 2024.

Although at this stage the exact requirements are uncertain, it is possible the UK regime will bear some similarities to the US Sarbanes-Oxley (SOX) regime. The proposed new rules could therefore mean a step change in the way controls are designed, implemented and embedded around treasury in general and payments in particular. "So it's all about access to and management of systems and the interfaces between them, segregation of duties, having appropriately defined processes and controls and a recognition of the level of operational risk," says Stebbings.

As such, he argues that the proposals, if adopted, "could change the way in which treasurers in the UK approach this topic in future." ■

Cash management gets real

Many treasuries still rely on manual processes and spreadsheets for cash management processes. But the COVID-19 pandemic has forced a reassessment of cash management and brought real-time liquidity and cash management closer to reality. New technologies are providing the catalyst.

Despite the advance of digital technology into everyday lives, many treasurers continue to rely on manual processes and spreadsheets. But the uncertainty and liquidity issues caused by the COVID-19 pandemic underlined the need for speed and accuracy in cash management. For many treasurers, the time has come to leverage new and emerging technologies and commit to a digital treasury environment that will enable real-time cash and liquidity management.

Financial technology provider Bottomline Technologies' 2021 Payments Barometer found that despite the cashflow challenges faced by many businesses, accurate forecasting is lacking, with 48% of the 800 organisations surveyed admitting their cash forecasts are rarely accurate. Among enterprise organisations, this lack of visibility increases to 56%.

However, the survey found that few businesses – 8% – aim to prioritise improving cash forecasting in the next 12 months. Financial decision-makers also tend to use more than one method to manage cashflow, with 37% of small businesses still using manual calculations on Excel, the survey found.

"The pandemic highlighted the need for accuracy and speed," says Tracy Kantrowitz, Vice-President of Marketing for Treasury at Bottomline Technologies. "Treasurers were the stewards of the information that CEOs needed in order to make business decisions about furloughing staff or keeping them on. A treasurer's role was no longer about just cash positioning and this shed a light on how inaccurate and inefficient existing processes were."

Tom Wood, Head of Global Liquidity and Cash Management, HSBC UK, says the pandemic has accelerated companies' existing digital treasury strategies. "Many treasurers were striving towards this pre-pandemic and treasury teams of all sizes and types of business are at different stages of their own digital development, as are their banks," he says.

Companies in the early stages of digital transformation have focused on automating processes such as administration, contracts and payments tracking, while more sophisticated and advanced treasurers are moving to decision-making tools for cash-flow forecasting. "Overall, there is more hunger from our client base to talk to us about real-time digital solutions than in the past, which is as expected given the impact of the pandemic."

Bert van Drie, Global Head Cash and Liquidity Management at ING Wholesale Banking, says there has arguably never been a situation as uncertain as the pandemic. "This has increased the importance of cash management for companies," he says. "Companies were suddenly confronted with drastically decreasing or increasing demand for their products and immediate and real-time insights in cash, lending facilities and (supply chain) risk management became even more important."

Stephen Randall, Global Head of Liquidity Management, Citi, says the pandemic refocussed the attention of companies on the importance of cash, in a similar way to the last financial crisis. "Companies realised they had to have a laser focus on concentrating cash and redeploying it to where it was needed most," he says. "This gave them visibility and the ability to best support the liquidity needs of the operating business."

Cash management has always been seen as important, says Peter Dehaan, New Business Director, Cash and Liquidity Management at technology company SmartStream, but much has changed. "The pandemic was almost like a natural disaster, overnight immediate and significant changes in working patterns and customer behaviours occurred," he says. "When you have such change you realise the importance of real-time, robust, auditable information which is readily available."

Normality changed much faster than anticipated, he adds. The human element and interaction that enabled organisations to successfully manage their business pre-pandemic was now at arm's length as treasury team members worked remotely. "Forecasting and visibility of the balance sheets were stretched, with companies drawing down on revolving credit facilities. In a number of financial institutions this was exacerbated given the volumes, essentially creating the need to establish a banking 'track and trace' system for cash movements."

The shift to remote working is a point also highlighted by Bottomline's Kantrowitz. Many treasurers felt comfortable with the status quo of manual processes and spreadsheets, she says, however during the pandemic team members were no longer able to walk up to a colleague's desk to ask a question, for example. Moreover, the collaborative technologies such as Teams that were used to enable staff to work together remotely made life easier and opened the eyes of many treasurers to the benefits of such technologies.

With the initial shock of the pandemic over and governments and businesses discussing recovery and 'building back better', existing cash management processes and systems are coming under scrutiny.

HSBC UK's Wood says there has been reluctance among some treasurers to move to digital treasury technology, caused by concerns over loss of control of processes and cyber risk. "There has always been an element of this, although digital processes are often more secure than manual ones," he says. "There is a shift away from this attitude, but there are always people who find it difficult to change historic systems and processes. The pandemic has forced a change away from dated processes that many people were very comfortable with."

Moreover, digital first was already the direction of travel for treasury functions. "Companies are moving away from physical

products such as cash and cheques, which are operationally cumbersome and generally higher cost," he says. Virtual account solutions and other digital technologies, such as HSBC Global Wallet, a new digital, multi-currency payment solution, will enable treasurers to transact faster and have better visibility.

All treasurers had similar challenges during the initial phases of the pandemic, says Kantrowitz, but those relying on manual cash management processes struggled more than those with more innovative cash management systems. The newer generation of cloud-based systems such as Microsoft Azure and Amazon Web Services enabled users to better connect the disparate pieces of information that typically reside in AP, AR and other accounting systems, she says. "From a decision-making point of view, the treasury infrastructures based on the new digital generation of treasury management systems fared much better."

The companies that had a handle on the fundamentals, with efficient and automated cash pooling structures already in place and the systems and data to monitor cash balances and forecast future liquidity needs, were able to more easily make decisions about cash deployment during the early months of the pandemic, says Citi's Randall. "Without the fundamentals, such decisions become more complex and deployment of cash is slower and less efficient."

Martin Gray, Managing Director in the Restructuring Advisory practice at risk solutions provider Kroll, says as a result of the pandemic, finance teams are "drastically changing in terms of their structure, organisation and processes. Thereby, businesses are scrambling to manage this adjustment by investing in their technological solutions. The accounting and finance branches have become a key area of focus for companies."

While the pandemic has provided a catalyst for reviewing cash management processes and systems, it is not the only driver. Instant domestic payments systems and the moves towards open banking and application programming interfaces (APIs) are highlighting the inadequacies of current cash management technologies. The proliferation of real-time clearing and settlement mechanisms will eliminate the established batch, end of day processing environment and will transform liquidity and collateral management.

Wood says one of the major benefits of digital treasury is its green credentials. "Technology such as digital cash flow forecasting tools can remove a lot of paper from operational processes while also removing inefficiencies."

Technology moves fast and pinning down any one technology that will emerge as the winner is difficult. Dehaan says cloud-based solutions are now more readily discussed by treasurers than they were a few years ago. "Portals and dashboards that align data are key to ensuring people do the right things at the right time. You have to ask yourself, what is worse, latent data or latent liquidity," he says.

Blockchain technology enables very fast real-time of actual cash positions. "Because of the transparency around it, you can see very quickly when something is wrong," says Digital Strategist Kate Baucherel. "Speed and transparency are crucial for cash management and blockchain transactions are much faster to settle because they don't have to go through any third parties."

The volatility of cryptocurrencies such as bitcoin (which are based on blockchain technology) has held back widespread adoption of blockchain in treasuries, however. "Stable coins, which are tethered to a currency or commodity are emerging and central bank plans for digital currencies indicate the area is constantly evolving. There isn't much confusion about what blockchain is, but there is a lack of knowledge because it is such a fast-moving area, which is common with any emerging technology."

The oft-quoted adage, "rubbish in, rubbish out" still applies. Artificial intelligence (AI), machine learning (ML) and robotic process automation (RPA) systems are only as good as the data that are fed into them. "Much of what treasurers are trying to accomplish in cash management will depend on high quality and accessible data," says Randall. "New and emerging technologies such as AI and ML are very useful and are bringing treasuries closer to real time liquidity management, which is becoming an important requirement. But treasuries must have good data to deliver on their promise."

ING's van Drie also points to data as an important element. "Data Analytics, robotics, blockchain and APIs are 'buzzword' technologies aimed at improving the treasury function. Fintechs in the open banking space, enterprise resource planning (ERP), treasury management system (TMS) providers and banks all step up to provide the platform for the future, particularly for real-time cash management, for cashflow forecasting and for risk management."

These solutions can bring tangible benefits in terms of better informed financial decisions, but van Drie warns that a careful strategy is required. "Which role do you want to play as treasury? Should it be fully integrated in the supply chain, or more focused on the financial and risk side? What is the culture of your company – more decentralised or centralised?"

Kroll's Gray says RPA is increasingly used by businesses to automate "monotonous" treasury management processes. "If businesses scale the technology properly and adopt a holistic approach, the future could be bright in terms of ROI for CFOs."

A technology is only as good as the organisational environment in which it works, he adds. Treasurers should consider how technology should function in the entire organisation and how easily data from subsidiaries of the right quality can be obtained and how the most value can be added.

Manoj Mishra, Vice-President, Consulting Services at CGI, says treasurers often feel "left behind" compared to their retail experience. "We are seeing treasurers demanding the same user experience that they have as a retail customer," he says. "Many treasurers and CFOs have made it clear to their banks that they should modernise or risk losing their business." Treasurers are seeking customer centric user experience, unified platforms and real-time, predictive insights, he adds. "We strongly believe that these changes in the next two to three years will help transform CFO organisations making them nimbler and efficient."

Highly connected, open treasury systems that enable easy onboarding of clients are the future of cash management, says Kantrowitz. "The biggest benefit of such systems is that they give access to data across all the financial ecosystems, including treasury, banks, ERP, TMS and accounting systems. Treasurers can unlock all of the data, using the right systems and tools to be more proactive and intelligent in analysis of cash flow and in vendor management." ■

SCF in China: harnessing technology

China's supply chain finance (SCF) market has evolved considerably in recent years – but there is still plenty of room for development. Taulia's Steve Scott and Haiyan Zhuang talk about opportunities in China's SCF market, the role technology is playing in driving progress, and how companies are using SCF to improve the resilience of their supply chains.

Steve Scott

Head of Asia Pacific

Haiyan Zhuang

Head of China

China's importance in the global trade arena is well known: it is both the world's second largest economy, and the leading global manufacturer. In addition, as the primary trading partner for 128 out of 190 countries around the world, China is the largest trading nation.

As such, supply chain finance (SCF) – a solution that allows companies to offer their suppliers early payment of their invoices via a third-party funder – has much to offer companies operating in China. In a nutshell, SCF allows companies to free up working capital for themselves as well as for their suppliers.

It also improves the predictability of payments for suppliers and reduces supply chain risks, thereby increasing the resilience of supply chains.

China is already embracing the benefits of this approach: the local SCF market is highly sophisticated and has attracted significant investment by a number of different parties. Haiyan Zhuang, the newly appointed Head of China at working capital solutions provider Taulia, notes that China's SCF market has been estimated to be around RMB10-15trn (US$1.5-2.3trn) – and that the government has been proactively encouraging the support of SMEs in China, particularly through the use of SCF.

"For example, in 2019 the China Banking Regulatory Commission (CBRC) and People's Bank of China (PBoC) published a specific policy to promote SCF in China," he says. "And last year, eight government ministries issued an updated SCF policy to promote and enhance its development."

And last year, eight government ministries issued an updated SCF policy to promote and enhance its development.

Haiyan Zhuang, Head of China, Taulia

SCF in China: challenges and opportunities

Nevertheless, regulatory considerations can also present challenges as well as opportunities for SCF providers. Financing and banking are highly regulated in China, as is technology and the use of data. "The regulatory regime is very different in China compared to Europe or North America, as are the customer personas, expectations of technology, and business models," Zhuang comments.

Another notable feature of China's SCF market is that for suppliers, the cost of funding can vary considerably. Different cities and provinces have varying levels of maturity, and risk levels can also vary depending on whether funding is sought pre- or post-shipment. As a result of the many variables, Zhuang says the cost of funding for suppliers could be as low as 3-4%, or as high as 10-15%. On the flipside, suppliers' access to capital has improved in recent years for a number of reasons, including the rapid development of the local SCF market and the arrival of new players in the market.

Another important driver is the rise of new technologies. From harnessing big data for quick credit profiling and information on the likelihood of default to the use of natural language processing (NLP) to handle requests more efficiently, there are many ways that technology can streamline SCF. And while the market has developed considerably, there is still plenty of room for improvement: "We believe technology can continue to play an important role in increasing efficiency across the whole SCF process," says Zhuang.

Harnessing SCF in China

So where does SCF have the most value to offer in China? Steve Scott, Head of Asia Pacific at Taulia, explains that the solution works best "where there are complex supply chains – and also longer supply chains, in terms of the cash conversion cycle." He adds: "Technology creates so much efficiency in the delivery of SCF that we can penetrate a deep supply chain, from strategic spend focused on the very large suppliers, all the way down to the mid tail and long tail of suppliers."

In particular, SCF tends to be focused on physical manufacturing industries such as electronics, machinery, equipment and consumer goods, explains Zhuang. "The typical SCF customer will have certain characteristics, such as high domestic or cross-border trading volumes or turnover," he says. "They will also usually have a high number of suppliers and distributors included in their supply chain, and multiple tiers of suppliers. The other factor is that payment terms across the supply chain tend to be quite substantial."

From localisation to cross-border capabilities

For Taulia, given the dynamic and competitive nature of China's SCF market, two themes are of particular interest – namely the importance of localisation and the need for cross-border capabilities:

- **Localisation**. Given the differences between the market in China and other countries and regions around the world, Zhuang notes the importance of growing "in line with the local regulation, legal framework, banking operations and processes around areas such as electronic KYC and connecting to government agencies for automatic verification and registration of accounts receivable."
- **Cross-border**. Taulia is focusing on MNCs that operate in China, with local sourcing and overseas exports – and also on large local corporates that purchase significant volumes with other countries. "Our key objective for Chinese corporates is to present our solution and our global capabilities, and demonstrate how we can improve funding efficiency across multiple locations," Zhuang says.

By focusing on these areas, the company aims to expand the reach and benefits of its solution to clients in China – such as enabling customers to transmit data efficiently through Taulia's platform, allowing suppliers to view data easily, and supporting banks in processing funding requests rapidly.

Future prospects

Looking ahead, Zhuang says the government is currently targeting 6-7% GDP growth – modest compared to China's growth in recent years, but nevertheless substantial – "so I believe the market will continue to expand." In the meantime, he notes that China's 14th five-year plan, the word 'digital' features many times.

"Building digital capabilities and a digital society is a national strategy," Zhuang concludes. "So I believe the relatively high growth rate, and continued wave of digitalisation, will mean that market conditions continue to be favourable as we bring our unique value to the local market in China." ■

Treasury's challenge: environmental performance and financial reporting

As investors increasingly clamour to see the relationship between a company's financial and sustainability performance, so treasury and finance teams will play an increasing role in integrating sustainability into financial reports.

Companies are setting increasingly bold environmental goals and ambitious commitments to reduce carbon emissions. Yet these important promises are rarely mirrored in their financial statements, making it difficult for investors and other stakeholders to see the relationship between a company's financial and sustainability performance. This could change if new sustainable accounting standards come to fruition and regulators act on growing investor pressure to introduce mandatory climate disclosure. Reporting the physical, transition and regulatory risk of climate change would go to the heart of companies' risk management and governance processes and calls for hands-on treasury and finance expertise.

The IFRS Foundation, the body that oversees the work of the International Accounting Standards Board, IASB, in setting financial reporting requirements for most companies in the world outside the US (where these requirements are set by the Financial Accounting Standards Board) is on track to launch a Sustainability Standards Board, SSB, at the UN's COP26 climate summit in November. All being well, the new standards will give investors and other stakeholders as clear a view of corporate sustainability as they currently do financial performance in one, integrated report.

Moreover, the different and acronym-heavy measurements and reporting standards surrounding ESG will be replaced

with a standard norm. "The idea is that all the different standards will converge into the SSB and take standards forward into the future," explains Emily Kreps, Global Director of Capital Markets at CDP, a global non-profit that uses investor pressure to cajole companies to disclose around environmental performance.

Elsewhere, Gary Gensler, Chair of the SEC in the US, recently spoke up in favour of the regulator forcing greater clarity and consistency in corporate climate disclosure, flagging new policies towards the end of the year. Earlier in June, the G7 agreed to force companies to report climate issues in line with the global Task Force on Climate-related Financial Disclosure, created in 2015 by the Financial Stability Board to develop broad but consistent climate-related financial risk disclosures for use by companies worldwide.

Carbon intensive industries

The need for financial statements to mirror the reality of climate change is important for all companies but particularly carbon intensive industries, says Barbara Davidson, a Senior Analyst at the Carbon Tracker Initiative, an independent financial think tank which analyses the impact of the climate transition on the capital markets. Her team combed through the sustainability and audit reports, proxy and annual financial statements of companies in the oil and gas, transport and utility sectors to see the extent to which climate-related risks and corporate climate pledges flowed through into financial statements to reflect changes like falls in product demand or commodity prices as the climate emergency grows.

Their findings are worrying. Despite COVID laying bare the impact of falling oil prices on oil companies' profitability, few oil majors reflected lower oil prices, declining demand in line with IEA scenarios, or regulatory fuel on the fire shortening the lives of assets in their expected future cash flows. "Faced with declining prices as a result of climate change, oil and gas companies will not be able to recover the value of their assets from expected future cash flows," predicts Davidson. "The costs of running these assets will also go up with efforts to reduce emissions and rising carbon prices."

Asset value

It's not just most oil groups inaccurately reflecting the resilience of their assets to climate change in their financial statements. A decline in demand for a myriad of products that emit greenhouse gases could hit all kinds of manufacturing plants making the products. In the transport sector, companies have made bold statements around electrification but the impact on the company of meeting these promises from increased costs, investment and the impact on margins is rarely accounted for.

As for utilities, companies need to accurately account for continued product demand in a low carbon world, and put the cost of changing their offering, the impact of regulation, access to renewable energy and costly new infrastructure into their financial reporting. "Do they have long-term agreements in place to purchase fossil fuels, and if so, how will regulation impact those agreements?" asks Davidson. "When we look at most companies' financial statements, we don't know if they have actually considered climate issues when assessing asset impairments." Elsewhere, she says few companies appeared to consider the costs and impact of their Paris commitments to reduce emissions in their financials.

The role of treasury

The task requires all hands to the pump. Finance and treasury teams need to understand how changes in corporate strategy and the impact of regulation will translate into the estimates they use to prepare their financial statements. Moreover, finance teams sitting in the heart of a business are in pole position to source information and act on it. "You can't have procurement making decisions on energy sourcing and not involve finance teams," explains Kreps. And because accounting for these issues will impact the operations of many companies, it requires governance and risk management expertise too. Teams made up of people from different business lines rather than keeping the process siloed in sustainability works best.

Treasury also has a central role explaining to investors how they are addressing the issue. Even if integrating the impact of climate change into financial statements is still early stage, treasury and finance need to show investors their sensitivity to the job in hand. Next comes board oversight to ensure the process is mainstreamed into the company, filtering into internal processes. "One of the first questions we always ask is if there is management level oversight, and where the team gathering the data sits," says Kreps.

Auditors

Auditors also play a role, challenging companies on how they are considering these issues and if financial statements are materially updated to reflect climate change. Calls for auditors to do more are growing louder. Many companies file their statements outside the US but list on the US stock exchange in a dual listing that follows two different audit standards. While the risks remain the same, US audit reports often exclude reference to any climate-related considerations. "It means the US market gets less information," says Davidson. "If US investors are only reading the US filings and US audit reports for these companies, they may receive less information than their overseas counterparts." A key challenge for auditors is that the timeframes that companies use for calculating expected cashflows do not always cover their timeframe for emissions reductions.

Getting started

A good place to start is disclosing to CDP, says Kreps. The process gives companies an understanding of the types of questions and information they will need to begin to source, builds capacity and educates. "What we provide gives companies a way to prepare for the regulatory environment we anticipate coming."

Evaluating, understanding and ultimately gathering the metrics companies will need is daunting. "They are not easy metrics to measure," she says. "It is a significant shift for companies to track, collect and estimate this forward-looking component. It is not like traditional financial disclosure where finance teams can assume how a business line or company will perform in the future – it is much more difficult to do this with environmental metrics."

But she insists the tools and methodologies are available, like the Science-Based Target Initiatives which have industry specific methodologies to help companies think about

Deutsche Post DHL

CASE STUDY

Deutsche Post DHL Group's Adam Pradela, Executive Vice President Corporate Accounting & Controlling and Klaus Hufschlag, Senior Vice President CREST Finance Business Intelligence & Analytics share the giant logistics group's progress on climate reporting.

We published our first environmental report in 2003. Since then, every year the process has evolved. In 2015 we produced our sustainability and annual report simultaneously for the first time and in March this year we produced our first, integrated annual report containing both financial and non-financial statements. In previous years the reporting process fell to other departments but now it is centralised under Corporate Accounting and Controlling.

The decision to centralise everything under finance has been essential. It has ensured we get the quality of data we need; finance has the skills to gather and process the data and now drives our reporting process. The other key thing we've learnt is that companies should treat greenhouse gas emissions like a cost and manage them down like a cost. Once you have the data, you can do this.

Moreover, we don't only want to report on our carbon emissions, we want to control them and drive them down. With this in mind, we have now introduced incentives from next year so that board members will have a flexible element of their salary tied to ESG targets rather than solely to financial achievements.

Since we published our accelerated roadmap to decarbonisation in March this year, we have seen a significant rise in our share price. Investors appreciate what we are doing. Carbon emissions are a very relevant KPI for our investors, and an area we can show good performance. We have improved our carbon efficiency by 37% since we started our CO_2 reduction programme in 2008. Importantly, our stock price went up at the same time as we announced plans to spend €7bn on sustainability by 2030 – the world of investment is going in this direction.

Regulation, increased customer demand as well as investor pressure, is driving our strategy. The new EU taxonomy asks us to show how much of our revenue comes from clean operations and the upcoming Corporate Sustainability Reporting Directive (CSRD) will increase the importance of sustainability reporting. It puts it on the same level as financial reporting and will make it a mandatory part of the annual report. We are quite ahead in these areas. Going forward, we need stability around regulation. We hope the IFRS Foundation will provide this when its new standards are published.

The majority of the €7bn will go into cutting emissions in our aviation arm – we are one of the biggest airlines in the world. We will gradually replace kerosene with sustainable fuel and plan to trial electric aircraft. Also, we started to invest in electric vehicles two years ago. Switching to electric vehicles is a step-by-step process when conventional cars come to end of the line and are replaced, therefore we currently have no needs to write down assets. One challenge is that there are few providers of electric vans – there is a limited capacity of suppliers able to deliver. Another factor is ensuring our suppliers and subcontractors are also interested in delivering sustainability.

We started gathering carbon data early on and have now connected to more than 80 operational systems. Operational systems were never designed for the purpose of external reporting, so we have had to ensure both the data quality and that we have the data in time to feed into our regular reporting. One of the biggest challenges is measuring subcontractor emissions because it involves establishing a data exchange process with our providers. Model-based calculations are not sufficient in the long run. Standardisation has also been a problem since everyone was calculating with different assumptions, but over the years we have achieved a good level of standardisation across our industry.

calculating their climate impact and modelling. Elsewhere, the PCAF (Partnership for Carbon Accounting Financials) helps financial institutions report their greenhouse gas emissions. "It takes time to adopt these different standards and understand them. The plane is being built as it's being flown, and this is disconcerting and challenging for treasury teams."

One potential catalyst for change could come from linking executive pay to meeting climate targets instead of using current metrics linked to profits. This in turn would make climate accounting and reporting processes central. "The more that compensation remains linked to profits which exclude climate targets, the harder it will be to shift practices," says Davidson, who notes that only "a handful" of companies currently link compensation to meeting emissions reduction targets.

IFRS standards may not be mandatory, and they are also likely to be location and industry specific. "A standard that is relevant to the EU could be different for a resource intensive economy like South Africa so there will need to be nuances," says Kreps. And although new standards will be unveiled at COP26, the reality will be a long, drawn-out introduction. IFRS accounting standards, and the generally accepted accounting principles, or GAAP, took almost 30 years for consensus. The process will be iterative and evolve over time, with the first mandatory disclosure looking very different from the third iteration. Still, the most important thing is for companies to get started on integrating climate impacts into their financial reporting. "Start now because the reality is the planet doesn't have the time," concludes Kreps. ■

Asahi's treasury story

Anthony Buchanan
Head of Treasury

Anthony Buchanan, Head of Treasury for Asahi's European and international treasury operations, describes a thrilling role at the heart of the business and the financial markets.

Asahi Europe is the European and international business of Japan's Asahi Group Holdings, set up when Asahi acquired SABMiller's beer businesses in Europe in 2017. Asahi is custodian of over 50 well-established local brands and runs 15 breweries, the oldest one dating back to 1615. The company brews 43 million hectolitres of beer every year and employs around 9,000 staff.

There is rarely a dull moment running Japanese brewing and food giant Asahi's European and international treasury operations. From supporting the group's expansion trail and helping integrate brands like Grolsch and Peroni or running FX and commodity hedging strategies, to expanding finance programmes or using treasury's muscle to push sustainability, combine to leave Anthony Buchanan little time to sit back and relax.

Hedging

Much of that time is spent managing complex commodity and FX hedging exposure in a business constantly buffeted by financial and commodity markets. The team hedge all transactional FX out to two years with a keen focus on large exposures against the euro in Romania, the Czech Republic and Poland due to supplier bases in these countries outside the Eurozone. "These are material markets for us – we review these currency pairs daily and investigate material forecast variances," says Buchanan, who joined Asahi in 2017, tasked with building the European and international treasury from scratch. "We had nothing: no people or systems," he recalls.

The need to hedge comes with the mismatch between paying suppliers and underlying costs in euros, versus Asahi

sales across central Europe, all reported in the local currency of the brewery. "We also have indirect foreign currency exposures where we know the underlying costs are being driven by euros, but everything is invoiced in a local currency," he explains. It requires clear sight of the underlying exposure, frequent discussions and planning with colleagues on the ground and staying across all currency movements. Currently front of mind is the strength in the Czech Koruna ("a good thing for us") and Poland's central bank poised to raise rates.

Further afield, his team have been providing FX support to Asahi's import-dependent Korean business, navigating an exotic Korean Wong/Czech Koruna currency exposure that is impossible to hedge, a process recently complicated further by trade tensions between Japan and Korea. "Although we are importing a European brand, it is owned by a Japanese company," he says. Just the type of knotty issue up for discussion in treasury's monthly meetings with the CFO and risk committee, where the team comb through all hedging exposures and price levels relative to the budget and market.

Commodities

In commodities he seeks to hedge a percentage of the exposures for up to four years. Yet like some currency pairs, his ability to hedge the risk of price moves is complicated in some markets because there is no tradeable commodity derivative which matches the exposure. Pilsner is brewed with Czech barley, yet hedging is impossible because there is no direct correlation between Czech barley and the main tradeable grains, unlike rival brewers which can use Chicago Board of Trade or US barley indexes to hedge their exposure. "We buy direct from Czech farmers and use tradeable grain prices (MATIF wheat and CBOT for corn) as a guide in terms of procurement, but we can't do a barley hedge as such," he says. It's the same in Romania, where heritage beers are also brewed with Romanian barley.

Inflation is another worry, currently manifesting around the spike in wages, transport costs and rising aluminium prices for cans. But here, at least, Buchanan's hedging strategy is reaping dividends. Aluminium prices have risen from US$1,600 to around US$2,400 a tonne in a fast trajectory, the brewer could never have reacted to in the commercial market by hiking beer prices. Luckily, the team locked in lower euro prices based on aluminium levels up to four years ago. "It is really competitive when you look at the market now," he says with relief. "A third of a cost of a can is aluminium."

Having hedges in place has allowed the company to avoid any knee jerk price response in a tricky COVID-era market, giving the business time to react to inflationary pressures and a little slack in the budget. As for PET (polyethylene terephthalate) within packaging, the company doesn't hedge even though there is opportunity to do so. "We decided it wasn't the right thing to hedge plastic: the right thing is to move out of PET," he says, turning the conversation to Asahi's sustainability drive, increasingly informing treasury strategy.

Sustainability

Visible is treasury's support of the group's bid to buy local players to produce as close to the market as possible. "Exporting beer is expensive and not particularly sustainable," he says.

Going local went further still, when his department supported one of the company's key suppliers seeking to build a factory closer to an Asahi's brewery and cut its logistics costs. The strategy involved setting up a supply chain finance solution with one of Asahi's banks to ensure the supplier could discount its invoices, supporting its working capital requirements. "Trucking empty cans to a brewery is expensive."

Elsewhere, he and the team are exploring longer-term green energy contracts. Asahi has just signed a ten-year electricity contract in Poland wholly tied to wind, in an offtake deal that helped the renewables farm finance its infrastructure build. "We had to hedge account it," he explains. "We helped the process by ensuring the guarantees required were priced correctly, and that we had approvals and tax sign off. We did a green energy hedge to provide enough documentation to ensure our auditors were comfortable with the reporting."

In other initiatives, treasury is now supporting the company in its efforts to use less plastic in its packaging and has explored green bond and green overdrafts – although he has no need for extra financing just yet. "We are sitting on excess cash, even after dividends."

Supplier financing

The inability to hedge barley prices in Romania and the Czech Republic makes long-term contracts with farmers essential. Key relationships treasury nurtures and supports with Asahi's procurement department wherever it can. Most visibly via a payables programme comprising vanilla supply chain finance for key suppliers, offering favourable payment terms with efficient discounting. It reflects his department's proximity to the inherent weather vagaries and farming fundamentals of the business. "The weather impacts our business on both sides," he says. "A rainy summer hits the grains and commodity markets, and also dampens peoples' appetite to drink."

As for the "other side," treasury has just stepped into receivable financing for the first time, taking advantage of a new, competitive edge in accelerating receivables in certain markets. It lies in the burst of supermarket sales due to lockdown, he explains.

The company has never developed a programme on the receivables side, mostly because the market segments, especially pubs with typically higher credit risk, have never looked that attractive to financing banks. Now, with a lockdown-triggered pick-up in supermarket beer sales, banks have grown more willing to offer the company a discount if it wants to accelerate the cash on receivables to big supermarket chains like Tesco or France's Carrefour and in markets like Poland, characterised by significant supermarket sales. Bank appetite has also been piqued by "cash being cheap" and lenders looking to make use of the excess funds they are sitting on, he adds.

"For pubs, payment terms are short at around two weeks, but supermarkets have much longer payment terms, and we are looking at opportunities in some markets to set up receivables programmes. We have found some quite interesting programmes in the Czech Republic, Hungary and Poland that will generate additional cash for us to repatriate back to Japan."

Centralised treasury

The need to keep abreast of the data and risk coming out of the business, volatility in financial and commodity markets, plus ensuring ample cash on hand to support the business and suppliers, has shaped Buchanan's highly centralised team.

Centralisation and tight control certainly make budget setting much easier. A complicated and risky process at the best of times given the gap between setting the budgets and having hedging in place to guard against potential market moves. Currently looking at his exposures into next year, but with limited amounts of hedging in place, he explains how he uses the forward markets to help estimate where he thinks the all-in hedge will come in 2022. The process involves taking account of current hedges and doing a weighted average with the forward market to align the business needs with market prices.

"It's challenging because some of these markets are controlled," he explains. "In Romania the market appreciation is slower than the forward points. If I used this as the input price, they would set the prices too high and wouldn't be competitive."

Banking partners

His treasury has around ten to 15 bank partners with a notable Japanese bias, but in relationships that are still subject to shifts and changes in markets. Because the business doesn't have any external debt, it doesn't have the usual historical relationship of core bank financing in return for lucrative mandates. Instead, the company works with central European-focused banks that can support around FX, commodities and cash management. "We don't have a massive exposure compared to some of our peers, but we need to ensure we get competitive pricing. We have around €600m in transactional FX against various local European currencies and some banks simply don't have this exposure or skills set."

Sounding a note of concern, he says the pool of banks able to offer commodity hedging is shrinking because of the regulatory and documentation burden. As for any changes in Asahi's banking cohort, he doesn't rule out the group introducing more banks to support its working capital agenda with skillsets specific to certain markets and growing Asian and Latin American exposures. However, prospective partners must offer value and avoid his pet hate of "constantly asking for meetings" but "never providing anything new." Elsewhere, he says the company reviews the share of the wallet and always provides feedback to relationship banks if they don't win the business, highlighting other areas where they could support the company.

Early career

It comes as little surprise that Buchanan was drawn to treasury because of its connection and proximity to the financial markets, a fascination he dates from early experience on a bank trading floor and in a junior treasury role focused on cash forecasting and shipping in an oil company. Later, at multinational drinks group Diageo, he got his first taste of the front office, helping run a volatile trading and hedging book (including interest rates) involving chunky risk and numbers. "I got really close to the market; we operated like a bank and had a P&L," he recalls. "It was a great learning into the FX market which was my key area of focus."

A career in treasury won over banking because of treasury's reach across FX, M&A, tax or financing, or indeed other areas altogether. He is currently working with Asahi's HR, exploring how to better rate and incentivise employees. "We are looking at employee goals and our review processes, seeing how they impact our bonus structure." Elsewhere, he has been closely involved with a complex building project around new corporate offices, working with utilities, furnishings and builders. "You have these kinds of opportunities working with a corporate," he says. "It wouldn't be the same in a bank."

Mentors

Mentors have played an important role in his career progression and treasury philosophy. For example, his belief in a centralised treasury was ingrained during his ten years at SABMiller as Regional Treasurer Americas (and latterly Europe) reporting to inspirational Treasurer David Mallac. In a busy travelling role, Buchanan was tasked with getting to grips with regional treasurers' cash assets, liabilities and currency exposures in the early stages of a sweeping centralisation strategy to persuade fiercely independent regional teams to come under one umbrella. "In those days we really weren't wanted; there was a lot of push back."

Success came when colleagues began to understand the value the central team was offering in an approach overseen and encouraged by Mallac. "He guided my relationships with individuals and situations." It was during this time Buchanan also learnt the value of face-to-face relationships and the importance of demonstrating value.

His time at a Peruvian subsidiary experiencing volatile costs and "horrendous" FX moves with the power to wipe out months-worth of P&L, comes to mind. Over time he demonstrated that a new cost structure and control of the currency element could help the sales side of the business. Next, he explained the need to forecast exposures, attach governance, controls and install systems.

Buchanan also counts his father as another key mentor. A chemist by training but latterly an entrepreneurial property developer, he has always counselled his son on the importance of understanding how to add value to a business to foster growth. It is his words that still ring in his ear when he is promoting treasury projects, putting "what the stakeholder requires" centre stage. "You have to demonstrate why it is important to them."

It is one of the key lessons he hopes his team (a front office of three with three sitting in a Prague back office) have garnered. He's just obtained board approval to add two more staff but says the heavily automated systems and straight through process suit a small treasury. As for his recruitment priorities, he will seek candidates with market knowledge and interest in the business. "Some people work in massive companies and really don't know what is going on." Elsewhere, he will look for ambition, a desire to develop the role and says candidates will also need the confidence to interact with senior colleagues in finance. "It's very easy to have conversations when everyone agrees. It's much more challenging when everyone has different views." The ability to switch off, particularly given lockdown's legacy of long working days, is another prerequisite. For him relaxation comes on a mountain bike, spending time with his family and sorting out a 700-odd vinyl record collection. "I also enjoy relaxing with a beer." ■

MMFs: what's new?

Money market funds (MMFs) faced significant pressures at the beginning of the pandemic – and more challenges are on the horizon, from continuing low interest rates and the prospect of further regulatory reform to the focus on ESG considerations in investment activities.

Money market funds have seen significant changes in recent years – and more is to come. Following the introduction of regulatory reforms prompted by the financial crisis, the volatility caused by the onset of the COVID-19 pandemic has once again triggered calls for change, with various proposals currently under consideration. At the same time, money market funds are facing additional challenges as a result of continuing low interest rates – and the growing focus on incorporating ESG into the investment process is also shaping the development of the sector. With that in mind, let's take a closer look at how money markets have fared during the crisis, and the factors that are likely to affect the direction of travel going forward.

From regulatory reform to a 'dash for cash'

Regulatory change has long been a theme in the world of money market funds. In the US, the 2008-2009 financial crisis saw the Reserve Primary Fund 'breaking the buck', with the resulting run on money market funds prompting significant regulatory change. In Europe, the focus of money market fund reform included replacing constant net asset value (CNAV) funds with low volatility net asset value (LVNAV) funds. In the US, meanwhile, CNAV funds were required to move to a variable net asset value (VNAV) model. In addition, both sides of the Atlantic introduced the ability to impose liquidity fees and redemption gates if liquidity falls below a certain threshold.

These measures were intended to make money market funds more robust in the event of another crisis – a goal that was severely tested in early 2020, when the beginning of the pandemic brought considerable volatility. The US saw outflows of US$125bn from prime MMFs in March 2020, which prompted the Fed to step in with the creation of the Money Market Mutual Fund Liquidity Facility (MMLF). European funds, likewise, experienced significant outflow pressures.

Laurie Brignac, Chief Investment Officer and Head of Invesco Global Liquidity, recalls the uncertainty that arose during the critical timeframe from February to the end of April 2020: "As economies began shutting down, we saw a 'dash for cash' as people and corporations sought to hold as much cash as possible amid the uncertainty that reigned at that time."

Initially, says Brignac, "we were wondering if we would see large inflows into money market funds since they are generally the 'flight to quality' vehicle of choice for many investors. By the time we started seeing outflows from money market funds and they sought to raise additional liquidity, dealer balance sheets were already quite clogged with other securities. It was a very tough time." Following central bank interventions, she adds, "markets did start to function more normally as they gained confidence that the central banks stood ready to provide support as needed."

Gauging the next steps

In the wake of these challenges, regulators are once again reviewing existing money market fund regulations to explore whether further action is needed. For one thing, concerns have been raised that some of the measures introduced by recent reforms may have had unintended consequences, particularly the use of redemption gates and liquidity fees to prevent redemptions if weekly liquid assets (WLA) fall below 30% of the fund's total assets. Preliminary research published by the Fed suggested that "the expectation that other investors will withdraw money and drive WLA below the 30% threshold may incentivise them to run pre-emptively before such liquidity restrictions are imposed."

In December, the President's Working Group on Financial Markets in the US released a report on money market funds, exploring the impact of the crisis and setting out potential reform options – albeit without endorsing any particular course of action. The Financial Stability Board (FSB) published a consultation report in June 2021, while the European Securities and Markets Authority (ESMA) ran a consultation between 26th March and 30th June 2021 looking at potential areas of reform.

The types of reform under discussion are wide ranging. According to Invesco's Brignac, potential money market reforms fall into four distinct categories:

1. **The operation and structure of liquidity buffers**. "For example, policy makers are considering removing the regulatory tie between portfolio liquidity and the potential application of fees and gates," says Brignac.
2. **Product changes**. Brignac notes that one proposal under discussion is "requiring money market funds to adopt a floating net asset value (NAV) structure, versus a constant NAV, to remove perceived regulatory 'bright lines' for investors – such as the liquidity buffer – and to reduce a perceived 'first-mover advantage' for investors seeking to redeem at par during periods of market stress."
3. **Bank-like reforms**. This could include introducing an additional capital buffer alongside existing liquidity buffers within funds, or mandating membership in a liquidity exchange bank. "We suggest policy makers reconsider the appropriateness of applying bank-like reforms to money market funds, not only because money market funds are not banks, but because they could undermine the vital role money market funds play in channelling liquidity to the real economy," comments Brignac.
4. **Sponsor support**. Brignac says that in the EU, regulators are considering whether existing rules should be strengthened to ensure the prohibition of sponsor support is absolutely clear – "while in the US, policy makers are considering introducing a framework governing sponsor

support to clarify the risks borne by money market funds and their sponsors."

Whichever types of reform are ultimately chosen, it seems likely that money market funds will once again see significant changes in the coming years – and as Aidan Shevlin, Head International Liquidity Fund Management at J.P. Morgan Asset Management notes, any period of change will create uncertainty. "Tighter guidelines should improve liquidity and security, but will also likely impact returns," he comments. "Meanwhile, any accounting changes will require internal adjustments to accommodate."

Low interest rates

Regulatory reform is not the only factor currently weighing on money market funds. Another challenge is the continuing issue of low interest rates, particularly given the high levels of cash currently held by many companies. "Following the outbreak of COVID-19, most companies significantly increased their cash balances," says Jonathan Curry, Global CIO Liquidity at HSBC Asset Management. "While some sectors have had to use portions of that cash, many others continue to hold balances that are much higher than their previous levels."

Low interest rates continue to present another challenge for investors when it comes to earning a return on that cash. "Globally, central banks have pinned base rates at record lows while markets are awash with liquidity, further depressing market driven yields," comments Shevlin. "Returns on many money-market instruments remain close to zero (in the US, UK, Australia, etc) or below zero (in the EU). Meanwhile, banks and financial institutions, caught between excess liquidity and tighter rules, are reluctant to accept additional time deposits." Shevlin notes that this has created significant challenges for corporate treasurers, who are still seeking to invest higher than average cash balances.

Against this backdrop, Curry says he has seen increased interest from corporate treasurers for ultra-short duration fixed income investment strategies that take limited interest rate and credit risk to improve yield. "These strategies can be a useful tool for corporate treasurers in a range of global currencies, but it's important to ensure that an investor weighs the risks against the opportunity for increased return," he observes.

Shevlin adds that a combination of diversification and step out strategies "should allow corporate treasurers to get fully invested and achieve a more competitive yield, while retaining a focus on security and liquidity." He also emphasises the value of good cash forecasting, which can allow cash to be segmented into operating, reserve and strategic cash categories – "allowing for different investment strategies to increase returns without significantly expanding risk."

MMFs and ESG

Beyond the impact of the COVID-19 crisis and the challenges associated with a low interest rate environment, a further factor affecting the development of money market funds is the growing focus on ESG and sustainability. As HSBC Asset Management's Curry observes: "We have seen a sharp increase in interest from corporate treasurers seeking to align their investment activities with their company's sustainability objectives."

A number of factors are driving this focus on ESG and sustainability, as Shevlin points out. "ESG considerations have rapidly emerged as a crucial challenge, especially as extreme weather events and the growing importance of equality have heightened consumers' and companies' awareness of these issues," he comments. "This implies that ESG factors are an increasingly important part of investing and the due diligence process."

As such, Shevlin says that treasurers are progressively seeking to incorporate ESG into their cash management and liquidity fund selection process. "Regulators and central banks are also considering incorporating these factors, with the EU setting early standards through the introduction of SFDR Article 6 and 8 funds classification system, while the European Central Bank is planning to establish ESG rules and is tilting its purchases towards green investments," he adds. "Across Asia, local regulators are also debating how to include and improve environment standards, with Hong Kong, Singapore and Taiwan all recently announcing ESG-related rules."

In this environment, Shevlin says a key focus for investors should be on understanding how ESG is incorporated into credit analysis and the security selection process. "If the credit analyst believes that the ESG factors are material and may impact issuer risks, the analysis will be reflected in the analyst's credit opinion," he says. "The ability to incorporate this analysis into the investment process and portfolio implementation is also important."

The way forward?

There's no doubt that the crisis has brought some additional challenges for money market funds – and with regulatory reform once again on the horizon, treasurers will need to be prepared for any future changes. In the meantime, money market funds still fulfil a valuable function for treasurers seeking to manage their short-term investments. As Curry points out, "Money market funds continued to play an important role in helping companies around the world manage these elevated cash balances through challenging economic and interest rate environments in 2020 and 2021." ■

Challenges in APAC

In the APAC region, the post-pandemic environment poses significant challenges for corporate treasurers, says Jonathan Curry, Global CIO Liquidity at HSBC Asset Management.

"While the support measures put in place by Central Banks are fostering economic recovery, they are distorting liquidity and suppressing yields, making it difficult for treasurers to find value in short term investments," he says. "Uncertainty around monetary policy also means that finding an appropriate investment for medium term and strategic cash is challenging, as investors look to limit their exposure to interest rate risk."

With the added impact on domestic economies from renewed lockdown measures and tighter border restrictions, Curry says treasurers in the region are "holding increasing cash buffers and prioritising capital preservation and liquidity until the economic outlook is more certain."

Don't be afraid to look through the hedge

Getting a complete picture of a company's exposure to foreign currencies is no simple task, but well worth the effort.

Foreign exchange is a significant cost for many businesses. A recent survey by Australian fintech Fluenccy suggested that SMEs in the UK paid more than ten times as much as corporates for FX when using their banks last year and lost an average of £17,000 on their international payments through a combination of excess fees and bad trades.

Fewer than 10% of the small businesses surveyed had access to a system that allowed them to monitor and control the impact of FX on their business. Fortunately, there are a number of steps companies can take to establish a full understanding of their exposure to foreign currencies.

FX risk can be divided into primary and secondary categories, the first of which being the actual cash flows of foreign subsidiaries and the second being the supply chains and macro risks driving FX exposure. An example of the latter is how exposure in Brazil can be affected by events in Argentina or Chile.

"In order to catalogue such risks, treasury teams need to think through the data they have on their outlays and receipts globally," says Bob Savage, Head of FX Sales North America at BNY Mellon.

Companies should take the time to understand the main types of risks across their industry and identify best practices across their peer group to ensure alignment with competitors, suggests Standard Chartered's Global Head of Financial Markets Sales, Sharad Desai.

"A global review of exposures at parent company and subsidiary level will ensure accurate understanding of group exposure," he says. "Companies should also assess the hedging risk generated by foreign investments."

Companies with multiple divisions, each with different pricing criteria, will have multiple sources of FX exposure. Within an industrial engineering firm, for instance, machine production, spare part provision, and service delivery will all generate different exposures.

Another important consideration is the forward discount/premium of the currencies involved. "European exporters typically sell in currencies with higher interest rates than the euro, such as the US dollar or the renminbi," explains Antonio Rami, Co-Founder of currency management automation software provider Kantox. "In this case, currency hedging entails a forward discount that must be effectively managed."

The scale of the company will also determine its ability to mitigate FX risk. A large corporate is likely to have a dedicated treasury management team with in-house experts as well as external partners, allowing it to implement a variety of risk management protocols.

"For a small business it is better to focus initially on the areas that are likely to affect the business the most and build from there," suggests Laurent Descout, Co-Founder and CEO of treasury services platform Neo. "Integrating a modern treasury management system into the business operations is the next important step."

Atlas FX is a provider of foreign exchange risk management services. The firm's Vice President, Strategy and Operations, Scott Bilter, says corporates need to go beyond the data readily available from their ERP system, create a forecast of future FX exposures, and put proper results analytics in place to understand the sources of FX variance.

"Getting each of these steps right requires a lot of expertise and treasury teams are often understaffed and highly rotational," he warns.

> Companies should also assess the hedging risk generated by foreign investments.
>
> Bob Savage, Head of FX Sales North America, BNY Mellon

Accurate forecasting – supported by a competent treasury management system – and centralised treasury enabling netting of foreign currency exposures are steps corporates can take to establish a full understanding of their exposure to foreign currencies agrees Ruth Bellinger, Head of IRFX Macro Sales UK at BNP Paribas Global Markets.

Options for minimising corporate exposure to FX volatility in current market conditions include adhering to a treasury hedging policy. A 'layered' approach remains popular whereby as certainty of forecasting increases in the shorter tenors, the amount hedged increases.

Borrowing in the currency of the asset or hedging via derivatives (such as cross currency swaps or rolling FX swaps) is another option.

"Highly structured derivatives may offer preferential exchange rates but will have additional restrictions whereby the hedge notionals may change on maturity or the hedge may fall away – usually at a time when market rates have moved adversely," says Bellinger. "Hedge accounting is also more challenging for these structured derivative hedges."

For cash flow hedging, the rule of thumb is to use forwards for highly predictable exposures and options for uncertain cash

CASE STUDY

California-based Electronic Arts has almost 10,000 employees worldwide and annual sales in excess of US$5.5bn. International revenue accounts for more than half of its sales, which means it is exposed to the effects of fluctuations in exchange rates across a number of currencies.

Strengthening of the US dollar relative to the euro, sterling, the Australian dollar, Japanese yen, Chinese yuan, South Korean won, and Polish zloty has a negative impact on its reported international net revenue but a positive impact on reported international operating expenses – particularly when the US dollar strengthens against the Swedish krona and the Canadian dollar. The company hedges a portion of its foreign currency risk by purchasing foreign currency forward contracts that generally have maturities of 18 months or less.

The company's treasury department processes around US$1.5bn every quarter across all transaction types, explains Grace Antonio, Treasury Manager. "We review all exposures – balance sheet and cash flow – via our exposure management system and our financial planning and analysis forecasting tool," she says. "We use spots, forwards and swaps to minimise our underlying exposure to currency."

Antonio adds that the company reviews its FX hedging strategy with its FX committee every quarter.

"We evaluate the types of hedging product we use regularly, but based on our strategy we don't often make changes," she says. "We have a rolling layered approach to our programme and even with changes in the market, we typically stay the course."

This strategy has worked well of late, with foreign exchange adding US$78m to the company's capital resources in the last financial year.

> Removing hedges where exposure is minimal is fine if the administrative burden of hedging is greater than the stress-tested risk of leaving the exposure unhedged.
>
> Scott Bilter, Vice President, Strategy and Operations, Atlas

flows. Corporate treasuries with long-term emerging market currency exposures face the choice between hedging at the expense of significantly affecting the return on the investment, or bearing the risk of significant currency devaluation.

"For balance sheet exposures, once the net exposures are determined companies should use a rolling programme with forwards with matching tenors as they provide the best offset from an accounting perspective," says Desai. "For long-term exposures including foreign borrowings, term hedges such as cross currency swaps can be used to mitigate the FX risk."

Companies need to keep up with a last moving market in order to buy and sell the necessary currencies (or their derivative products) quickly, efficiently and at a low cost. This is almost impossible to do successfully without access to the right data as well as real time FX market rates and execution capabilities.

"The fact that there still are many manual processes around FX risk management is pushing corporates towards further automation to improve efficiency and internal controls," states Descout.

Customised analysis of an organisation's FX exposures can also make a crucial difference. Minimising exposure requires an understanding of what could go wrong from all potential sources of variance and applying a stress test to each one, suggests Bilter.

"It is ultimately accomplished by properly hedging, but the devil is always in the detail," he adds. "Reducing forecast deviation, having properly timed hedging workflow to avoid unnecessary slippage against accounting rates, and being able to interrogate any re-measurement inconsistencies are all necessary elements in minimising FX volatility."

According to Desai, corporate treasurers have increasingly turned to options this year in response to pandemic events. The need to react to external events demands constant monitoring of currency hedging strategies.

"Hedging strategies require constant review and removing hedges when there is no longer a need for them is a clear principle for lowering FX 'noise' in the balance sheet," says Savage. "However, while this seems simple some exposures end quickly and the unwinding of hedges takes time – balancing liquidity against spreads is more art than science."

Desai refers to a significant shift this year with a growing number of so-called 'black swan' events prompting corporate treasurers to increase the frequency of their hedging strategy reviews.

These strategies should be continuously reviewed to reflect the diversity of pricing criteria and the widespread adoption of flexible pricing in many industries, adds Rami. "As expectations for short term interest rates shift, so does the situation firms face in terms of forward points," he says. "That calls for continued assessment of hedging strategies."

Descout reckons any strategy designed to monitor FX exposures and hedge against risks should be monitored at least every day and ideally in real time.

"Relying on spreadsheets is simply unworkable and outsourcing this important task can result in slow decision-making, poor service and high costs," he says. "Recent advances in technology mean it is possible to access all of the key services corporates need – such as real time data and analytics, access to live FX rates, execution and hedging capabilities and multi-currency accounts to make and receive payments – via a treasury management system."

Significant volatility in an unhedged currency or from a hedged currency with a hedge percentage below 100% might indicate a need for a change in strategy.

"Significant volatility from 'spot slippage' would indicate the need for either an improved workflow, an improved hand off between income statement and balance sheet trades, or improvements to how FX liquidity trades are managed," says Bilter. In this context slippage refers to the difference between the expected price of a currency trade and the price at which the trade is executed.

A sizeable market shock or heightened currency volatility could require an immediate review of a programme that was running fine. In the case of cash flow hedges where the business units are involved in their specific strategy, it is important for treasury to review these hedges with the business unit at least annually as some key aspects of the business may have changed.

"Removing hedges where exposure is minimal is fine if the administrative burden of hedging is greater than the stress-tested risk of leaving the exposure unhedged," adds Bilter. "Understanding why the exposure is limited is important though. Was it larger before and is only temporarily smaller? It may still need to be monitored, even if left unhedged."

Bellinger also suggests a hedging strategy should evolve as the company changes, whether this is a strategic change in the company's direction or as a result of disposals or acquisitions.

"The merits of removing hedges for currencies to which the corporate has limited exposure depend on the currency – the limited exposure may be in an emerging market which has much greater volatility and a small position may create a significant P&L impact from market movements," she says.

The ability to forecast future exposures has been the subject of much conjecture among treasury teams over the last 18 months. The pandemic has seen many companies experience unexpected impact on their order books with major discrepancies in what was forecasted and hedged.

With this uncertainty likely to persist for some time, corporates would be well advised to keep their FX risk management options open. ■

Treasury's preference: remote, hybrid or in-office?

> *As employers prepare for post-pandemic employment, what working structures are most treasury teams pursuing and what are the key benefits and challenges to consider?*

Richard Tonge

Principal, Global Mobility Services
Grant Thornton LLP, New York

As companies move toward hybrid working arrangements, there are many broad issues to tackle from tax and regulatory compliance to real estate and business strategy. Finance and treasury departments need to be attuned to these different impacts and plan effectively alongside other parts of the business. And when it comes to tax and human resources, there are real obligations to consider by allowing people to work in different countries (in the US this applies to different states too), away from their home working locations. Treasury will need to assess what this means from a cost perspective, and where the company is putting its funds.

Earlier in the pandemic, authorities announced reliefs to mitigate unintended tax consequences of having people work in places where ordinarily they wouldn't be. Largely, however, these no longer apply. Where employees are still working remotely or in a hybrid arrangement, there is now the potential of companies accruing tax risk in these different countries. Treasury will have to think how this could impact the audit and how the business should address this.

It is important to remember, however, that while the working landscape has changed, the tax regulatory landscape hasn't – we are back to where we were pre-pandemic, governed by double tax treaties and other bilateral and multilateral tax and social security agreements. This means employees in a different country could foreseeably create corporate tax exposure. Treasury and finance teams will have to determine if that individual could, by virtue of how long they are there or what they are doing, create a permanent establishment, which is deemed as a corporate taxable presence for the company and could force the company to pay corporate tax in that foreign jurisdiction.

There are also risks for companies as employers. Companies may need to register as an employer or operate a payroll. If companies don't do this, they are potentially liable for the tax not withheld for the employees in that location. In short, it could open the company to employment taxes it might not otherwise be subject to, and in Europe particularly, the employer social security costs can be significant.

Although it's still early days to identify what enforcement activity will be taken by tax authorities, we've seen cases in Israel and New Zealand where employees working remotely have been contacted by tax authorities and told they need to pay taxes. This tax season could put employees on those tax authorities' radar when tax returns are filed – and companies must be prepared to address any tax consequences that arise.

The workforce has been liberated in a way unforeseen at the start of 2020, with many businesses that wouldn't have considered hybrid working now accommodating what employees want – which is now amplified, given it's an important source of talent attraction in a post-pandemic work environment. Companies must find a way to navigate a path forward that meets their business needs and manages tax and employee obligations. By leveraging tools to track the correct tax requirements for an employee's work locations and the element of change management around the payroll, companies can effectively tackle these new complexities.

Serina Hourican

Head of Global Commercial Sales, Asia Pacific, Global Transaction Services, Bank of America

We are seeing our corporate clients adopting various work arrangements, with some bringing staff back and others offering the flexibility to work from home. There are some who have adopted new approaches such as designating a specific day per week for people to be in the office for in-person interaction and meetings. One of our clients did that and I thought that was an interesting approach.

For us, we are also gradually getting our employees back into the office, in line with local guidelines in various markets. We believe that an office environment works best for our employees and that it helps with the interaction and culture building. Our juniors and interns will also benefit from the in-person coaching and mentoring that will take place by being in the office.

We are also seeing changes to recruitment practices. There is now more flexibility such as hiring talent from locations outside of the office where the role is based. For instance, some of our US headquartered clients are now asking if they really need to have in-country roles for their Asia Pacific operations. They are exploring if it may be best to hire in the US for now then relocate those employees in Asia as the business grows to meet local regulations and guidelines.

While there have been various upsides to remote working, it has also brought to the forefront the importance of mental health and well-being of employees. Working from home over such a long period of time meant that the lines between working and personal hours are now blurred. It is not unusual to hear that people are working longer hours, with commuting time now spent on emails and calls instead. There is a real element of virtual fatigue as people are working much harder to stay connected with colleagues as compared to being in the office.

As the world moves on to gradually reopen, we will start to see various models being tested and adopted but one thing is certain, the future of work will continue to evolve.

Rohan Gunatillake

Group Treasurer
Golding Homes

We had a flexible working policy in place even before the pandemic and our approach to ways of working will remain flexible and the individuals will continue to be managed by outputs and measured in terms of meeting their goals. We know some colleagues would benefit from more time spent together and some individuals have expressed a desire for a blend of office and remote working. Our response to this will be to introduce a "Hub, Home, Roam" approach which will rely on trust and flexibility.

We have used the feedback gathered from colleagues to put together a plan for future ways of working at Golding Homes and consider how colleagues can safely return to the office over the coming months. We will be doing everything possible to support and keep both colleagues and customers safe. We always had a flexible working policy and given the success of remote working over the past 18 months, we will explore the possibility of further expanding the flexibility of recruitment policy in treasury as necessary.

Clearly there will be fewer face to face bank meetings in the short to medium term and it's likely the trend will continue in to the long term. As the treasury team is small, we managed to keep the team dynamics broadly the same during the pandemic and made a conscious effort to have more frequent conversations with the team members. Whenever possible we reduced the number of emails and had video calls with the colleagues instead. We set aside some of the saved commuting time to have non-work-related catch ups.

We will continue to use various internal communication channels to promote treasury successes to the wider business. Long working hours and the blurred work life balance was clearly harmful. As a result, we are having ongoing discussions in the team to constantly remind each other of the importance of having a clear separation between work and personal lives. Also, the blend of remote and office working going forward will hopefully aid in getting the right mindset to have a clear separation and avoiding potential long working hours.

Despite experiencing some challenges in performing certain tasks, overall productivity and efficiency has improved. Frequent team catch ups have strengthened both the professional and personal relationships among the team members. The individuals have become more open and supportive of each other than before.

Ben Walters

Deputy Treasurer
Compass Group

There's a real acceptance that the office is all about connecting with people now to develop collaboration, swap ideas and to illicit support and development. At the same time, the ability to work remotely is also extremely useful especially when you just need to "get things done". A healthy balance between both is our rationale for the way forward here.

The benefits to take from our working patterns over the last 18 months is the flexibility afforded from a hybrid working style. If used correctly it should boost productivity. We are all aware now of the toxic side of working remotely. It can be very difficult sometimes to switch off, especially when you see colleagues and external contacts burning the midnight oil. Not many of us really miss the commute, but the separation it gives between work and home life has an important purpose.

Other aspects of the job are harder when carried out remotely. Training people for example is often something best done when sitting someone down and focusing on the subject matter. Picking up on body language and directing towards an objective can also be much harder to do on a Zoom or Teams call.

It's not so much a question of what's changed with remote working, as what hasn't. The level of professionalism, dedication to the cause and hard work have been maintained throughout the last eighteen months. The department has faced many challenges, many of which were not even considered a possibility pre-pandemic, but these have all been overcome. ■

Next question:

"What will be the most important implications for treasury teams to come out of COP26 in Glasgow? How should corporate treasury prepare?"

Please send your comments and responses to **qa@treasurytoday.com**

Interest rates

Real interest rates were fairly negative before the summer and have since declined further as a result of persistent high inflation and a decline in nominal (long-term) interest rates. Negative real interest rates are generally a positive for financial markets and economic growth, as they make it appealing to borrow and use the money for investment. In addition, debts will weigh less in real terms. This has a positive impact on assets such as equities and property, and it exerts downward pressure on credit spreads.

However, real interest rates should not decline too rapidly, as this could be interpreted as a sign that economic growth will fall back considerably.

It is not immediately clear whether the markets interpret negative and declining real interest rates as being positive or negative. On the one hand, equity and house prices have stayed under upward pressure, and credit spreads have faced downward pressure. This indicates investor optimism.

On the other hand, the decline in real interest rates had coincided with falling commodity prices, a flattening yield curve and a decline in nominal long-term interest rates. These are all signs of declining growth.

Low real interest rates could have several possible causes. This makes it difficult to interpret what they are telling us.

First of all, bond investors may anticipate a considerable decline in economic growth and inflation due to the surge in corona cases and the expectation that the impact of fiscal policy on economic growth will shift from a strong stimulus in recent quarters to a considerable decline over the next few quarters.

The Delta variant has been spreading rapidly, while many people have not yet been vaccinated. Moreover, fully vaccinated people can also transmit the virus and the vaccines offer far less protection after about six months. Booster vaccines will probably offer (sufficient) additional protection. However, it will take a while before everyone has received this booster. In the meantime, concerns about the pandemic could slow down economic growth and many economic data could prove weaker than anticipated.

At the same time, several structural negatives for growth – ageing populations and soaring debts – have strengthened. Finally, inflation has been rising faster than wages in many countries, which affects purchasing power (and consumer confidence).

The above facilitates a scenario in which the economy has been experiencing a boom due to vaccinations and large-scale fiscal stimulus, but that a bust is in the cards. Concerns about deflation could resurface by then, prompting central banks to (further) ease monetary policy.

The decline in real interest rates over the summer could also be due to temporary factors that don't reflect underlying economic strength:

- In spite of high inflation, the Bank of Japan and the ECB have announced that they will not raise their rates in the coming years. The Fed is considering pursuing a less loose monetary policy, but it will remain very accommodative for the time being.
- Over the summer, the US government has withdrawn and spent vast amounts of money from its Fed account. This has resulted in a considerable amount of additional liquidity in the economy, on top of the money that the Fed pumps into the economy every month. This has exerted even more downward pressure on interest rates. The government will continue to withdraw money from its Fed account until Congress raises the debt ceiling. This could increase downward pressure on interest rates and reinforce upward pressure on asset prices. However, once the debt ceiling is raised (this is expected by November at the latest), analysts believe that the government will raise the amount in this account by issuing debt securities, thereby removing net liquidity from the market, which will exert upward pressure on interest rates.
- Real interest rates have also been depressed by problems and disruptions on the supply side of the economy. The labour market has been disrupted by the corona crisis, as a result of which many companies are struggling to recruit sufficient staff. This has also disrupted supply chains, resulting in a shortage of computer chips, while (sea) transport takes longer and is far more costly. This has exerted more upward pressure on prices. At the same time, economic growth is depressed, as companies cannot produce as much as they want. However, it is assumed that many of these problems will gradually disappear. This will give economic growth a boost and will depress inflation. Base effects also play a role in the latter.

We believe that the decline in long-term nominal and real interest rates has been mainly due to the temporary factors. Growth is unlikely to decline to the extent where concerns about deflation resurface and where monetary policy ends up even looser than now.

Growth is likely to fall back, but this will largely be due to mounting concerns about the corona variants, less fiscal economic stimulus and problems on the supply side.

However, more concerns about covid variants will also result in a higher vaccination coverage. There will still be major problems on the supply side, but they will gradually decrease. If more people are vaccinated, more people will return to the labour market. In addition, we believe that companies will have partly solved the supply chain problems in a few months from now.

In the coming quarters, economic growth will be slowed down by fiscal policy. On the other hand, job growth will increase, and consumers will still have considerable savings and healthy balance sheets will give them more scope to borrow. In other words, (consumption) growth could persist, even in the absence of looser fiscal policies. In addition, we believe that companies will step up investment activity to catch up on investments that were shelved last year, and to reduce dependence on long supply chains and scarce staff.

In conclusion, we anticipate persistent downward pressure on economic growth in the months ahead, but growth is set to pick up in the ensuing period. We anticipate a similar scenario for inflation. Inflation will initially come under more downward pressure due to decreasing base effects and the gradual disappearance of problems on the supply side in a few months from now. However, inflation will subsequently end up at levels higher than before the corona crisis, as an ever larger proportion of surplus money created by central banks will flow to the real economy. This is due to, on balance, persistent high public deficits. Another reason is that households will spend more of their savings.

Based on the above, we have the following expectations:

- Nominal interest rates will not rise significantly in the short term, but they will rise in subsequent quarters.
- Expectations of a less loose Fed policy will fade in the coming months, after which they will increase; by that time, we also anticipate more speculation on Fed rate hikes as a result of relatively high inflation (expectations) by that time.
- Real interest rates are unlikely to decline to far lower levels in the months ahead and they are likely to rise in the ensuing period. ■

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GOLD SHINES

IN PALANTIR'S TREASURY STRATEGY

Big data company Palantir's investment in gold bars had some conspiracy theorists wondering whether the company had insider knowledge – from its government contracts – of an impending disaster. Although an unexpected move from the cutting-edge software company, it has put gold back in the spotlight as a treasury strategy.

Investment in bitcoin and other cryptocurrencies has been a growing trend, particularly for innovative corporations that are looking to diversify and pursue new hedging strategies. So, when Palantir – the big data software company founded by legendary investor Peter Thiel – announced it had invested in gold bars, it caused something of a stir. For such a cutting-edge digital company, many expected an equally digital investment strategy.

In its latest quarterly update, the company reported that during August 2021 the company purchased US$50.7m in 100-ounce gold bars. "Such purchase will initially be kept in a secure third-party facility located in the northeastern United States and the company is able to take physical possession of the gold bars stored at the facility at any time with reasonable notice," the company said in its filing with the Securities and Exchange Commission (SEC).

Palantir has been described as an espionage firm because of its contracts with the likes of the Central Intelligence Agency (CIA) – which was an early investor – and the Federal Bureau of Investigation. It has been portrayed as a secretive, big brother firm that wields too much power given the data it has access to. In one of its contracts, it scraped data for the UK's National Health Service to understand how coronavirus was spreading, and its data analytics were used in the UK's vaccination programme.

If a company like this is investing in gold – which it can access at short notice – does it mean it can foresee a black swan event on the horizon? Is the visionary Thiel – the co-founder of PayPal and an early investor in Facebook – onto something while others are missing a trick by focusing on cryptocurrencies instead? Or is gold just a sensible hedging strategy for the company?

To put the US$50.7m gold investment in perspective, it is actually chump change when compared even to the personal wealth of David Glazer, Palantir's Chief Financial Officer and Treasurer. According to Benzinga, Glazer's net worth is estimated to be at least US$149m. He owns approximately 2.5m units of Palantir stock and sold an estimated value of US$51.9m in the last year.

And the amount of gold the company has invested in is still small, relative to its other assets. As of 30th June, for example, it had US$964m invested in money market funds and US$65m in certificates of deposit.

One view is that gold's value is expected to increase as the value of the US dollar declines. Jeffrey Gundlach, the CEO and founder of investment firm DoubleLine Capital, who earlier in his career was dubbed the 'King of Bonds', says the US dollar's future as the global reserve currency is under threat. "I think ultimately gold is going to go a lot higher, but it's really in hibernation right now," he was quoted as saying by Yahoo Finance.

And according to the World Gold Council's report that was released last week, investors are increasing their allocation to commodities, given the improving economic conditions, higher inflation and rates expectations as well as commodity supply shortages. ■

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