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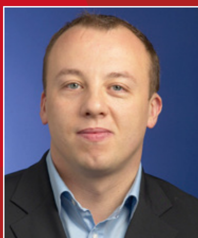
Treasury gets to grips with Scope 3

Companies can't get to net zero if they don't get to grips with their Scope 3 emissions. Corporates, banks and ratings agencies discuss progress.



The Corporate View

Mark Hirst

Group Treasurer

Dr. Martens

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The inflation conundrum

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The view on 2022: the trends set to shape the treasury landscape

As 2022 gets under way, this edition explores some of the most important issues set to drive treasury policy in the year ahead, including digitisation and reducing emissions. Our main feature sets the scene, polling a variety of treasury and corporate experts on what they perceive as treasuries' key challenges in the year ahead. Cybercrime, supply chain issues and the consequences of vaccine inequality make the shortlist. Rising energy prices, accentuated by greenflation as green politics continue to reduce the supply of key raw materials and slow investment in oil and minefields, will also stay front of mind.

This edition also explores the role of treasury in supporting companies to reduce their Scope 3 emissions, an immense task that has left many stuck on how best to proceed. EDF's Head of Treasury, Bernard Descreux, explains how his team is leading initiatives at the French utility to reduce emissions in its supply chain that include issuing social bonds to finance its SME suppliers and launching a reverse factoring programme. Proof that these policies are beginning to work is evident in the fact EDF reduced its Scope 3 emissions by 11% last year.

Elsewhere, we look at how digital assets promise opportunity beyond just investing in bitcoin. Digital assets have the potential to transform how treasuries – if not whole businesses – are run. One example we explore is how tokenisation could transform the ownership and access to industrial assets, such as machines, planes or trains.

In our Corporate View, iconic shoemaker Dr. Martens' Group Treasurer Mark Hirst describes how he is building out the treasury function in support of the newly listed company's pursuit of revenue and profit. This includes the need for a hedging programme to manage the growing number of currencies used to transact as the company's direct-to-consumer sales grow – another key trend shaping every treasury landscape.

Finally, now is your moment to shine! The acclaimed Adam Smith Awards, now in its 15th year, opens for nominations on 31st January. Everything you need, including our short nomination form, is available online at treasurytoday.com. Nomination will close at midnight on 11th April and we look forward to receiving your nominations. Good luck!

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Treasury gets to grips with Scope 3

Scope 3 emissions are typically the biggest part of a corporate's carbon footprint and the hardest to unravel and measure. But companies can't get to net zero if they don't get to grips with emissions in their supply chain. Corporates, banks and ratings agencies discuss their progress.

Earlier this year, the treasury department at French utility EDF structured and sold the energy company's first social bonds to investors. The proceeds have gone to finance capex purchases from EDF's SME suppliers supporting generation and production activities at its nuclear fleet and electricity network, particularly targeting small businesses in areas of high unemployment.

In another endeavour linked to EDF's promise to support its suppliers reduce their own carbon emissions and promised in the company's sweeping Mission Statement, it introduced a reverse factoring programme last year. It offers preferrable discounting rates to its suppliers when they reach a certain level of ESG integration in their own business. So far, supplier uptake of the ESG-linked supply chain credit has been slow, due in part to cheap, government-sponsored bank financing to SMEs, but Bernard Descreux, EDF's Head of Treasury believes it will pick up going forward.

Both treasury initiatives have been driven by EDF's ambition to reduce its Scope 3 emissions, the carbon footprint of the components in a company's product and of those products once in use. Scope 3 emissions are typically the biggest part of a corporate's carbon footprint and the hardest to unravel and measure. They also reveal an important granularity: a coal mining company won't produce huge emissions in its mining processes (Scope 1), but use of its product (Scope 3) has a profound impact on global emissions; Tesla's production processes score poorly in ESG ratings because manufacturing the electric car is a carbon intensive process, but the product has minimal downstream emissions.

At EDF, Scope 3 emissions comprise the burning of gas sold to end customers as well as purchased electricity the company sells; emissions from the firm's minority generation assets plus all purchased goods and services, explains Matthew Reed, Head of Sustainable Finance Development, part of EDF's finance team tasked with finding, measuring and financing the reduction of EDF's total carbon footprint. "We reduced our Scope 3 carbon emissions by 11% last year, part of a targeted 28% reduction by 2030," he says.

Both Descreux and Reed link progress to the company's overarching climate strategy for carbon neutrality across all emission scopes by 2050 where the focus is on decarbonisation rather than offsetting emissions. The group's commitment to next zero resulted in EDF's finance and treasury teams drawing up a Sustainable Finance Strategy to fund the company's transition. Social bonds and ESG-linked supply chain credit are the latest tools in an armoury that includes an €8.7bn green bond programme to date used to finance the bulk of EDF's renewable and hydro-electricity investment. "You need a clear-eyed carbon strategy," advises Reed. "Before pulling the levers, you need to be clear of the goals."

Basis points

Banks are offering a growing array of financial products to support companies getting to grips with their Scope 3. Citi offers corporate clients a sustainable supply chain finance product that incentivises their counterparties to improve their sustainability by offering preferable rates of financing and services. Like the overlay it applied to its existing supply chain offering for German chemical and consumer goods company Henkel, seeking to nurture resilience and incentivise sustainability across its supplier base. "We created two universes," explains Parvaiz Dalal, Global Head Payables Finance at Citi in London. "Henkel's most sustainable suppliers received favourable pricing with a certification process while Henkel's traditional suppliers remained on our basic product offering."

Citi uses a certification agency to check and rate the sustainability of all companies in the buyer's supply chain, segregating them into green, amber and red. Different sleeves within the programme allow suppliers to move up the ladder and tap preferential financing and services if their sustainability improves. "We find that suppliers in the programme categorised as 'red' typically strive to improve their sustainability and reach 'green' accessing the ensuing rewards for helping Henkel deliver on its sustainability goals," says Dalal, who links the burst in client demand to the pandemic. "Since COVD, companies are looking with much more detail at their counter parties; how things are sold and where and how they source."

The ability to move up the ranks is crucial to the programme's success and embodies the proverbial 'journey' inherent in ESG integration. "It is not a one-time exercise," says Dalal. In Citi's traditional supply chain finance programme, corporate clients' suppliers are onboarded through a light KYC process and not treated as the bank's clients. In contrast, under its Sustainable Supplier Finance programme, Citi reviews its clients' suppliers' certification and ESG status every year to allow 'red' suppliers to improve to tap the benefits and keep already 'green' suppliers on their toes. Buyers typically concentrate on their biggest emitters in the first year; in the second year they dig deeper and in the third year look at their long tail suppliers.

Getting started

Colour coding belies the complexity of tackling Scope 3 emissions. For many treasury teams, the biggest challenge is simply working out how to measure emissions in their supply chain. Rather than an industry standard or universally consistent metrics, the measurement landscape is populated by different ratings providers fighting for market dominance. "It is not an established market place," says Mark Douglas, Managing Director, Strategic Accounts at supply chain finance platform PrimeRevenue, who adds that buyers and suppliers often use different rating agencies making it even more difficult to compare data.

Deciding what to measure is equally boggling. Companies can make the same product but with different carbon components depending on the buyer, while treasury teams struggle to feed data into their ERP systems. Finding the required data is certainly onerous. Suppliers need to detail and provide evidence of every potential sustainability credit or black mark from the source of their energy to the diversity of their workforce. It's created a mixed level of enthusiasm. Tier 1 suppliers are quick to onboard, but Tier 1 suppliers' suppliers are notably less willing. "This is where the conversation tends to get tougher – they don't want to be dictated to," says Douglas. Still, motivated by the belief it will help them win business, he notes that more companies are accepting that it is an imperfect system and taking the plunge.

Onboarding requires engagement and patience. Descreux hopes EDF's social bond programme will become an important source of knowledge transfer, helping suppliers grasp and benefit from their role in supporting the utility's sustainability targets. "Accessing this finance involves deep discussions on how suppliers can contribute to our goals," he says. "Sustainable finance is something that is still very odd to many people within a company and within a treasury. It's important to help people understand what it means."

At Tesco, which became the first UK retailer to offer a sustainability linked supply chain finance scheme to its supplier base last year via a platform developed in partnership with Santander, the priority has been balancing a fair and credible scoring system with a process that is not too time consuming and complex for small suppliers. The company has tailored the methodology for SMEs so that the data ask is less onerous, explains Alex Ashby, Head of Treasury Markets for the retailer, where Scope 3 emissions make up more than 90% of the company's total emissions footprint and where treasury came up with the supply chain concept in 2019.

Ratings agencies have an essential role in creating confidence in the grading system and preventing greenwashing. At French ratings agency EcoVadis, suppliers are rated and certified annually taking into account their policy, actions and results, explains Sandy Gray, Private Equity Sustainability Solutions, North America at the company. She also stresses the importance of rating agencies verifying the information they receive from suppliers to instil market confidence. "Rating providers should only utilise self-assessment questionnaires if they are accompanied with polling of that company's policies, actions, results and verification of the information. Suppliers have to realise someone is watching them and that a rating is not a free ticket."

She also notes that progress on Scope 3 reporting is still slow, partly because of the detail of information and data required. Only 15% of the 90,000 odd companies EcoVadis rates can successfully report on their Scope 1, 2 and 3 emissions. "Companies can only begin to harness the emissions in their supply chain when they have a firm handle on how to calculate and report on emissions," she says.

> Henkel's most sustainable suppliers received favourable pricing with a certification process while Henkel's traditional suppliers remained on our basic product offering.
>
> Parvaiz Dalal, Global Head Payables Finance, Citi

Benefits

A Scope 3 strategy brings recognition and rewards from investors. Speaking during a recent webinar hosted by FCLTGlobal, the not-for profit that aims to focus capital on the long-term to support a sustainable economy, Jim Fitterling, Chairman and CEO of Dow highlighted growing investor pressure on companies to get to grips with their Scope 3 emissions – and the rewards of action. Fitterling urged large corporates to "get on board" with Scope 3 and help SMEs in their supply chain reduce emissions. "We are working on our Scope 3 emissions with our suppliers, building it into our supplier partnerships with a clear line of sight," he said. The company is also reducing Scope 3 in its products, many of which increase energy efficiency in buildings in line with emerging building codes and government policy.

Companies not taking action increasingly feel investor heat. Groups like Climate Action 100+, a group of global investors striving to ensure the world's largest corporate emitters act on limiting their carbon footprint, have utilities in their sights. Like renowned laggard South Korea's Korean Electricity Production Company, (KEPCO), monopoly owner of the majority of South Korea's 50-odd coal-fired power plants. Climate Action 100+ investors are ratcheting up the pressure on the company to limit and exit coal and fossil fuel extraction to fuel its energy production with the threat of divestment.

In one encouraging trend, integrating Scope 3 is resulting in more private companies cutting their emissions. The argument goes that private companies, out of the public spotlight and free from looming regulation like mandatory climate-related financial disclosures for listed companies, are slower to cut emissions. But Gray points out that around 70% of EcoVadis's 90,000 corporates are SMEs, the bulk of which are private. "We have developed a methodology that can work equally in public and private companies, across countries, industries and enterprise size," she says.

Companies the world over have pledged carbon neutrality by 2050 but unless they get to grips with emissions in their supply chain, they'll never meet their commitments. "You can't be net zero as a company if your Scope 3 emissions are heading to net zero. They have to try and influence it," concludes Prime Revenue's Douglas. ■

REDUCING SUPPLY CHAIN COSTS DEMANDS FLEXIBILITY

There is no single solution to the problem of increased shipping and logistics costs.

Supply chains are creaking across the world. In North America, corporates have seen the cost of moving a shipping container from Asia increase twenty-fold, while risk management specialist Gallagher estimates UK high street businesses have lost £9.3bn as a result of supply chain disruptions over the last 12 months.

Data from IHS Markit suggests that it takes three times as long to unload a container at a US west coast ports as it does in China. An obvious solution is to get more people working across the supply chain, but that is an issue no corporate can resolve on its own.

What corporates can do is attempt to renegotiate their logistics costs. According to research conducted by Gallagher, one-in-six UK businesses have done this successfully (although a similar percentage said they had simply absorbed these increased costs). Exploring alternative shipping routes might be a possibility, but this has to be weighed against the impact of longer delivery cycles.

Switching to local suppliers is another option worth exploring. Fifteen per cent of the companies surveyed by Gallagher planned to switch to domestic suppliers in 2022 to avoid cross-border shipments, while 28% of the 500 medium-sized businesses surveyed by BDO in July planned to on-shore suppliers by the end of this year, explains partner Ed Dwan.

"Almost a third (29%) intend to increase the cost of their product or service, while a similar percentage have reduced the product lines or services they offer," he adds.

Stephane Crosnier, Accenture's Supply Chain and Operations Lead in the UK, says some companies are reviewing their haulage and delivery contracts to see whether there is scope to partner with other businesses to reduce empty space in containers and vehicles and this improve efficiency.

"Another medium-term solution is to re-evaluate service levels," he says. "Prioritising premium customer delivery is key, but it is possible that internal service levels could be reduced. For example, some stores or branches may be able to cope without a daily delivery if they have enough inventory."

However, he also acknowledges that corporates shouldn't be looking at logistics purely as a cost and that measures to offset higher prices need to be weighed against the knock-on impact on the customer experience. "Longer dispatch times or reduced stock, for instance, may hurt customer relationships," he adds.

Technology has a role to play in improving the transparency of supply chain flows, according to Amy Shortman, Vice President of Overhaul. Risk management platforms can aggregate data from logistics ecosystems into a single unified view, enabling shippers to ensure they are getting the service they have procured.

"Consumers have come to expect near real-time information on shipment status and arrival times as standard," she says. "How this data can be used when combined with situational details is where the transformation occurs – bringing in external variable factors that may impact the shipment such as weather, traffic or even risk levels of cargo crime."

The due diligence process is often not detailed enough when it comes to second or third-tier suppliers and for many businesses there is a worrying reliance on a single supplier in one part of the chain, adds Neil Hodgson, Gallagher's Managing Director of Risk Management. "Businesses also need robust continuity management policies and procedures," he says.

In the meantime, corporates may look to cash in over the festive season. Paul Martin, UK Head of Retail at KPMG, observes that limited availability of stock has created strong pricing dynamics, which means we are unlikely to see any major discounting this Christmas as retailers bank on consumer willingness to buy the most sought after items at any price. ■

AVIVA INVESTORS

Brightening economic outlook ushers in returns on corporate cash

Corporate treasury teams should look forward to a rosier economic outlook and better returns from liquidity funds, say Aviva Investors' Stewart Robertson, Senior Economist for UK and Europe and Richard Hallett, Head of Liquidity Portfolio Management, speaking in a recent webinar.

Stewart Robertson

Senior Economist (UK and Europe)

Richard Hallett

Head of UK Liquidity Portfolio Management

The economic outlook holds real reasons to be optimistic. Economies are recovering from the pandemic and inflation and rising interest rates are a sign of economic growth and the return to more normal economic conditions.

Inflation is likely to spike further, but it is also likely to be transient, particularly since one of the main contributors to current inflation levels is high energy prices. They account for between 1.5% – 2% of the inflation rise but are forecast to fall back, says Stewart Robertson, Senior Economist for UK and Europe at Aviva Investors. Although inflation brings challenges, it is also indicative of our journey back to more normal economic conditions.

Supply chain issues are leading to higher inflation and are front of mind for many corporate treasury teams. But pressures in the supply chain should ease as supply begins to catch up with demand. Freight rates already look like they have peaked, and the global chip shortage is starting to ease. "It is a good news story and governments are right to think about withdrawing the policy stimulus," says Robertson.

A rise in interest rates makes sense given the stronger economic outlook. "If we are optimistic, why do we need emergency policy settings anymore?" he says. Moreover, markets are anticipating policy change, indicative in the yield curve moving to reflect interest rate rises ahead and the sterling curve now pricing in 1% for base rates next year.

The recent sell off in the bond market is also reflective of a growing awareness that rates are going to rise. One of the reasons equity markets have not sold off is – in keeping with a more optimistic view – economic growth ahead. Expect corporate bonds with weaker balance sheets to suffer most and "old world" corporate bonds in sectors like tobacco or oil to underperform, says Richard Hallett, Head of Liquidity Portfolio Management at Aviva.

Rather than viewing the prospect of monetary tightening with concern, corporate treasury teams should see higher interest rates as a reflection of things getting better. Although policy rates will climb over the next few years, they will do so in an orderly fashion and are unlikely to be as high as they have been in the past. "We need to get used to a slow journey to tighter monetary policy," says Stewart.

Liquidity

The positive macro backdrop suggests treasury teams might finally be able to tap better returns on their cash holdings. Corporates are beginning to take advantage of more return seeking strategies and taking on a little more risk; tying up cash for longer and taking some credit risk gets better returns than six months ago, notices Hallett. He also notes a spike in demand for segregated mandates as companies with large amounts of cash on hand seek better returns than a traditional liquidity fund via a bespoke mandate.

Treasury teams can tap different strategies to position their cash portfolios for the rise in base rates. For example, corporates can reduce duration strategies and buy shorter dated products or floating rate products, balanced perhaps by fixed rates in the longer term. "Treasury teams are finally getting paid something for their investment," says Hallett.

Going forward he advises treasury to focus on new restrictions in MMFs bringing both benefits and challenges. ESG integration in short term liquidity funds will also become more of a priority. "We are going to see more liquidity funds have to demonstrate they have green policies and are embracing the ESG ethos," he concludes. ■

If you missed the webinar and would like to hear the full recording, this is available at ***treasurytoday.com/webinars***

The view in 2022

As a tumultuous year draws to a close, Treasury Today considers some of the existing and emerging geopolitical risks corporates will have to manage in 2022.

Before we even consider the global pandemic it is clear that 2021 will go down as a year of considerable social, economic and political upheaval. The election of Joe Biden as US president, the revival of the black lives matter movement following the murder of George Floyd, the emerging implications of Brexit, and extreme weather events linked to climate change have all had a profound impact across the world. Covid has been a sobering reminder of how interconnected the corporate world has become and is a theme that straddles several of the risk factors we have highlighted below.

To paraphrase former US Secretary of State for Defence Donald Rumsfeld, there are things that we know we don't know but there are also things we do not know we don't know. With that in mind, over the following pages we explore some of the geopolitical risk factors most likely to exercise the minds of corporates over the next 12 months and look at what steps can be taken to mitigate these risks.

Cybercrime

State-on-state activity is an obvious geopolitical risk factor, particularly in the grey zone (defined as the space between peace and war) which has been evident recently in the recent activities of Russia on its border with Ukraine and China's comments on Taiwanese sovereignty.

"Countries are less willing to take each other on directly and will instead push the boundaries of diplomatic and economic action, which includes activities such as cyberwarfare," explains Neal Croft, Global Client Relationship Director and Head of Geopolitical Risk at Willis Towers Watson.

According to Nicholas Fitzroy, Risk Briefing Director at Economist Intelligence Unit, the way the conflict between Israel and Iran is unfolding has considerable implications for cyber-security. "There were a number of attacks on Iran's nuclear facilities initially and then that expanded to cyberattacks on national infrastructure such as petrol pumps," he explains. "Now we have seen Iran hacking online medical records of citizens within Israel to cause reputational damage. So we can see it has quickly expanded beyond just trying to hit the other state in strategic ways and become a broad 'cyber war' that affects all types of citizens and businesses."

Being aware of the specific level of threat is vital. "It is important to track the types of cyberattacks that are coming from these states because the strategies they are using and the targets they look for are constantly shifting," adds Fitzroy.

For businesses, the current geopolitical and cyber risk landscape means that organisations are at heightened risk of being caught in the virtual cross-hairs of what could be considered a global game of cyber chess.

Croft recommends corporates conduct strategic analysis to identify the risk factors with the highest potential impact. "Once they have done that they can work out a risk management strategy and stress test their assumptions through techniques such as scenario development," adds Croft. "It makes sense to reduce risk such as cyber-security exposure before insuring what risk remains."

Energy supply

Gas prices across Europe increased substantially in the autumn due to tight supply, a surge in demand on the back of economic recovery and lower than expected output from renewables. As winter progresses further price increases are likely.

"Eastern Europe in particular is heavily dependent on oil and gas imports from Russia and recent Russia/Europe tensions regarding the former's possible annexation of Ukraine could leave European consumers exposed to supply disruption and further price increases," explains Sophie Heald, Head of Modelling at Cambridge Econometrics.

Jason McMann, Head of Geopolitical Risk Analysis for decision intelligence company Morning Consult notes that Germany's new government will have a considerable impact on energy availability in Europe in 2022. "Olaf Scholz's administration would potentially have to jeopardise energy access via the Nord Stream 2 pipeline (a new export gas pipeline which runs from Russia to Europe across the Baltic Sea) if it takes a more aggressive stance against Russian expansionism, particularly on the Ukraine issue," he says.

Corporates can mitigate this risk by diversifying supply sources geographically, investing in low-carbon solutions, and sourcing more sustainable suppliers.

US foreign policy

Joe Biden has been pushing the line that the US is back in full diplomacy mode and the withdrawal from Afghanistan was a very clear example of the country's reduced appetite for armed conflict.

"Ironically, this might increase the risk of conflict because powers that oppose the US may think they can push harder," explains Fitzroy. "The US midterm election results at the end of the year will likely ramp up pressure on Biden and the Democrats as they look like they might do quite poorly, increasing internal distractions and reluctance to be dragged into new conflicts."

Fitzroy says the territories most likely to see conflict are Iran and Ukraine. "When the Russian economy is suffering – and

more importantly when the population is showing much less support for Putin and his regime – there is a precedent for expansion of military foreign policy as we have previously seen in Syria," he adds.

Iran is also a potential flashpoint in the next few months because the prospects for the nuclear deal negotiations succeeding are very low and all the while Iran is ramping up its nuclear programme. "If those negotiations fail there aren't many options on the table other than some form of military action," says Fitzroy.

It is therefore important for corporates to understand the knock-on effects of conflict. Assets in Kiev or Iran would face an obvious physical threat in the event of armed conflict and there are broader threats around the imposition of sanctions on entities working in these countries.

US-EU bonhomie has increased markedly since Biden came to office, but whether this translates into closer coordination on the foreign policy front remains to be seen. Both sides have made some progress on resolving transatlantic tariffs issues, but have not yet decided when (or if) to pursue a united front against China, particularly with respect to market access and the Taiwan issue.

"President Macron's push for a more independent EU foreign policy and struggles in presenting a unified front against Russia remain challenging," says McMann. "Germany's new government will likely be the determining factor in the China issue – if it is more willing to push back regarding Taiwan it is likely to suffer economically given its close trade relations with China."

Vaccine inequality

Pandemic mitigation measures include demanding that employees are vaccinated, mandating the wearing of masks, and limiting the number of people coming in and out of buildings at the same time, although most corporates have already implemented some or all of these strategies.

"More broadly, it is about taking advantage of opportunities that may arise in 2022 because what we saw at the beginning – especially in Europe – was lockdowns that went on for three months or more and I think countries where possible are moving away from that," says Fitzroy. "There may be local lockdowns and specific types of curfews – and vaccine passports might be introduced – but I think countries have realised they don't have to lockdown for so long or so broadly."

Former British Prime Minister Gordon Brown has warned that low vaccination rates in poorer countries has enabled new variants such as Delta and Omicron to emerge and spread rapidly even across countries where the majority of the population are double jabbed. From a commercial perspective, a much more unstable business environment is likely to develop as individual countries create a more fluid lockdown system. This will cause some confusion, but also provides short-term opportunities.

"Corporates need to be aware of the way the political wind is blowing in their particular markets," adds Fitzroy. "Reluctance to reintroduce full scale lockdowns in some countries is driven by domestic politics, so understanding domestic politics in each country is very important when dealing with unpredictability."

Rising nationalism

The trouble inflicted on economies domestically by Covid also increases the risk of more authoritarian nationalist regimes pushing for external distractions.

"A global wave of rising populism can coincide with increased nationalism and potential risks to multinationals on two fronts – limitations on their ability to invest in foreign markets and maintain multinational supply chains without government pushback, and ability to sell in foreign markets," explains McMann.

Should nationalist sentiment rise further in 2022, corporates should aim to determine the extent to which such sentiment is fuelled by popular pushback against foreign companies as opposed to anti-immigration attitudes. The latter has been a flashpoint in recent years but determining which way the needle is likely to swing will help guide corporates' investment plans and supply chain positioning. McKinsey makes the point that geopolitics is personal and that large organisations are likely to have stakeholders with differing cultural reference points and opinions on issues from human rights to privacy – differences that can dissolve into disagreements about risk and strategy. In a world where nationalistic sentiments are on the rise, no country dominates, and regulations and standards are fragmenting, such situations are bound to accelerate.

Supply chains

Lindsay Newman, a Director on the country risk team at IHS Markit adds supply chain resilience to the list of challenges, noting that corporates will need to predict, assess and manage the changing landscape through intelligence and data analysis, benchmarking and scenario planning.

"The challenge for firms operating globally is not how to exit but how to stay in markets," she adds. "Firms will face risk as they seek to capture opportunity."

According to János Hidi, Sustainable Investment Manager at Cambridge Econometrics, uneven access to coronavirus vaccines will further accelerate the trend of deglobalisation and supply chain restructuring. "Current uncertainties appear more risky because they pose immediate risks to businesses," he says. "For international companies global supply chain risks are material, but are more under their control than political risks although it takes time to reallocate production."

Sonia Baxendale, President and CEO of Global Risk Institute observes that populism has seen the rise of protectionist practices and barriers enacted due to actual or perceived security concerns, such as in the US-China trade relationship. "Stress tests will feature highly in risk management practices that may include scenarios of embargoes on certain jurisdictions," she says. "It is important to maintain a conduit of local knowledge to fully understand the nature of the risk rather than hearing it second-hand via media sources, for example."

McMann acknowledges that restrictions on Chinese firms doing business in the US and/or working with US suppliers and the Taiwan issue do not have easy solutions. "However, our data shows voters are open to reducing tariffs in the interest of driving prices downwards and a clear majority want to avoid direct military conflict with China, suggesting that compromise and reduced tensions are potentially on the cards in 2022," he says. "For these reasons, we advise corporates to hold tight on their existing supply chains." ■

Bootmaker Dr. Martens' treasury transformation

Dr. Martens Group Treasurer Mark Hirst discusses the challenge ahead following the iconic bootmakers FTSE 250 listing.

Mark Hirst
Group Treasurer

Dr. Martens is a British clothing and footwear brand headquartered in Northamptonshire. The footwear is distinguished by its air-cushioned sole and yellow stitching. Dr. Martens' design studio is in Camden Town, London, the manufacturing is in the UK and Asia and the company listed on the London Stock Exchange last year.

One of the most compelling motivations behind Mark Hirst's decision to take the job as new Group Treasurer at Dr. Martens, the brand renowned for its chunky lace up boots and yellow stitching, was the challenge inherent in building a new treasury function. "It is a build, not a rebuild," he enthuses in an interview from the company's London headquarters in Camden, reflecting on the basic set-up of the existing treasury function at the bootmakers when he joined last June, tasked with driving and supporting the newly listed company's pursuit of revenue and profit. "There is a lot to do."

His first priority is to recruit a six to seven-strong treasury team with relevant skills and experience, a process he says has proved slower than he'd like in a reflection of the tighter employment market. With no systems or processes in place, his next is to build out treasury technology and transform a system currently run off spreadsheets. "Our ERP system is Microsoft Dynamics 365. Getting the technology up to speed and recruiting the right experience and skills are foundation enablers for the transformation of treasury here at Dr. Martens."

TMS vendors are bombarding him with offerings, but he wants a clear understanding of the treasury stack before he takes the plunge. He is also mindful of treasury competing for resources with other parts of the business also hunting new technology capability and programmes. "We can use spread sheets for another few months yet," he says.

Dr. Martens' need for a new treasury comes despite the company being around for years. The original shoemaker, owned by the Griggs family, was founded in 1901 in the small town of Wollaston, Northamptonshire. It wasn't until the 1960s that the company began manufacturing the unique boots designed by Dr Klaus Maertens, a German soldier who'd shaped the shoe to aid his recovery from an injury.

It is Dr. Martens' more recent history that stripped out much of the treasury function needed for a listed business. Private equity group Permira paid £300m for Dr. Martens seven years ago when it bought a majority stake off the Griggs family. In January 2021, Permira exited most of its shareholding when the company listed on the FTSE 250. Today, Premeria is still the biggest shareholder and has a board seat, but all decisions from the capital structure and balance sheet; how much debt the company has and what that should cost, fall under Hirst and his CFO Jon Mortimore's remit. "How we take the business forward is purely now a company decision."

Direct-to-consumer

Another urgent priority is putting in place a treasury system to support the company's fast growing direct-to-consumer business currently spanning over 60 countries. Although Dr. Martens' different channels to market span shops, wholesalers, distributors, and some franchise agreements via hubs in London, Portland, Oregon and Hong Kong, the group's own e-commerce platform offers the most exciting growth and revenue trajectory, accelerated by trends emerging from the pandemic. "Customers who hadn't shopped with Dr. Martens before, are now buying direct from the website."

DM has rolled out new, country-specific payment methods for on-line customers wanting alternatives to Visa, Mastercard or PayPal that include national providers like the Netherland's iDEAL. "Customers in some of our key markets want local payment methods. We've also had to expand our offering with a gift card and BNPL solutions," he says.

As global sales grow, Hirst also wants to expand treasury's ability to manage the growing number of currencies used to transact and the different currency revenue coming into the

business, much of which is converted daily for liquidity. It has exposed an urgent need for a hedging programme, something he is exploring via an extensive currency mapping exercise across the whole group designed to understand the company's net exposures and natural offsets. "We weren't on top of it and didn't have the right risk management approach," he says.

The main currency exposures are cable, sterling euro and euro dollar but he is increasingly aware of the need to look more closely at hedging the renminbi in line with the company's growth in China. In its first annual report last June, Dr. Martens registered overall sales growth of 15% led by demand from China which soared by 46% – the company has just appointed a managing director in China. "We are developing a new strategy for China, so renminbi is potentially another material currency exposure treasury will have to manage," he says.

Developing the hedging programme requires working closely with colleagues to identify the exposures as they are created. The key is to make sure the company's forecasts are granular enough to flush out the correct exposures, he explains. "We rely heavily on regions to provide accurate numbers to ensure we don't end up over or under-hedged or have a material exposure that is not hedged at all." He is also exploring a multi-bank platform as part of a technology project that would allow the group to price-tension its FX contracts.

Cash on hand

Elsewhere on his list is the need to maintain a sensible level of cash on the balance sheet. Although Hirst is not planning to hold "ridiculous amounts of cash," he wants the business to operate with reduced leverage in the next 12 months from which point a decision will need to be made about what to do with surplus cash.

Current debt on the balance sheet comprises a euro-term loan drawn shortly after the company listed. "Our net leverage is very low and will continue to go lower as we go through the next couple of years." The company tracks and monitors net leverage because it is the only financial covenant in its facilities, due to expire in February. He adds that for now the company has significant headroom. "The last thing we want is another lockdown, but we have ample headroom on our covenant."

Banking partners

Hirst spent a fair proportion of his first three months meeting the company's banking partners to understand their different roles. "It was a question of working out who is doing what and who needs what as a result of being our lender," he says. In a reflection of how Permira had structured the financing, he unearthed a surprisingly long list of banks including some he'd never dealt with before; a handful outside the UK and one private equity-owned lender. HSBC, the house bank grounded in a long-standing relationship with the Griggs family, is an important seam of continuity.

Supply chain finance and sustainability

At some point in the first half of FY22 up he'd like to introduce a supply chain finance programme with the company's key Asian contract manufacturers. "A supply chain finance programme would be a win-win for us and our suppliers," he says. It would also be a good way to nurture and cajole ESG integration in Dr. Martens supplier base in line with the company's new commitments to sustainability that include a target of zero waste in its value chain going to landfill by 2028; net zero emissions by the end of the decade and all shoes made from 'sustainable materials' by 2040.

He says treasury is still in the process of carefully considering all the ESG finance and opportunities out there. "Over the past couple of years, the banks have become increasingly keen to burnish their ESG credentials. Credit ratings agencies are also getting in on the act and are looking at ways of giving 'credit' to companies which embrace green initiatives." He also notes that the hard financial savings are often fairly minimal – usually about 5bps. "We don't want to rush into something that later turns out be an onerous exercise in collecting and monitoring a multitude of KPIs."

Hirst's enthusiasm for Dr. Martens' treasury transformation speaks of his appetite to learn and push himself that has run throughout his career. First seen when he swapped consulting after a graduate trainee position on PwC's coveted management consultant programme and brief stints at Deloitte's and KPMG, for hands-on proximity to the sharp end of business and industry. "I wanted a proper job," he jokes.

That came when he joined Tesco, initially as an internal auditor in 2005 before progressing to group treasury where he focused on the international side of the business. "It was a high profile, interesting introduction to all things treasury," he recalls. His time at Tesco included a three-year stint in Asia, based in Bangkok, from where he covered the retailer's markets in Japan, South Korea, Thailand and Malaysia. The role was particularly centred on working with Tesco's bank partners in an experience that has shaped his thinking on banks relationships with their corporate clients. Back in the UK, he took another role managing cash and banking across the group before leaving in 2015 to join ill-fated travel and airline group Thomas Cook as UK Treasurer.

The same ambition to put his stamp on treasury and oversee new processes and systems that inspires him at Dr. Martens, drew him to Thomas Cook. The company was coming out of a prolonged rough patch, and Hirst was tasked with leading and shaping a new treasury to support the business in its recovery. As it was, the job turned progressively tough as the company failed to win back its foothold in the competitive package holiday business renowned for wafer thin margins. "It was a tough experience," he says.

Hirst left three-and-a-half years in and a year before Thomas Cook finally folded. Still, it was long enough for a front row seat on corporate trauma. Drowning in debt, Hirst describes a financial strategy that applied sticky plasters over gaping wounds. "It was hard. We could see it coming but couldn't do enough; the business couldn't turn itself around quickly enough."

One of his poignant learnings was the different relationship a small, ailing company has with its banking partners clamouring for a return on capital, compared to a large corporate with the muscle to draw concessions. "Banks are more willing to help big companies. It's a different ballgame when small companies are facing challenges."

Coping with the hard lessons of corporate failure bought his own guiding treasury mantra to the fore. Hirst concludes with a note on the importance of learning, pushing oneself and being able to adapt. There is no such thing as a typical day in treasury, especially at Dr. Martens. "I have a long list of things I want to do," he says. ■

Addressing supply chain disruption

With supply chain disruptions increasingly widespread, how can companies harness technology to overcome the challenges brought by high levels of uncertainty? Alexander Mutter, Managing Director, Head of Enterprise EMEA at Taulia, shares his views.

Alexander Mutter

Managing Director
Head of Enterprise EMEA

While people around the world may be beginning to look beyond the pandemic, supply chains continue to face major disruption. Shortages of products including semiconductors and shipping containers have threatened production and lengthened transit times. At the same time, severe port congestion in the US, the global energy crisis and the UK's HGV driver shortage have all challenged supply chains in a variety of ways, from soaring costs to late deliveries.

The impact of these issues has been felt around the world. "Globalisation means that supply chains are incredibly complex," says Alexander Mutter, Managing Director, Head of Enterprise EMEA at Taulia. "An issue taking place in one country can have significant reverberations in other countries."

With China accounting for almost 15% of global exports in 2020, Mutter notes that an increase in demand from China is contributing to fluctuations in the availability and pricing of certain resources. "The demand we see is not just in semiconductors, but also in raw materials including wood – in fact, the price of wood has doubled in the last couple of months, while delivery times have increased from four weeks to six to eight months," he notes.

Supply chain goals

According to Mutter, these disruptions have sharpened the focus of the C-level on finding new ways of protecting businesses from supply chain disruption. "The COVID-19 pandemic, in particular, showed how fragile global trade and supply chains are," he says. "And of course, if you have experienced the risk, you have to find a solution."

In this climate, Mutter says CFOs are focusing on three key considerations:

- **ESG** – many companies are focusing on driving improvements across some of the UN's 17 Sustainable Development Goals (SDGs), and are setting clear targets that they are looking to achieve over a given timeframe. Against this backdrop, a lot of companies are also looking more closely at supplier relationship management. Whereas previously companies may have focused on profitability and negotiating attractive pricing, today the focus is more on partnership and achieving joint objectives with suppliers.
- **Digitisation** – data visibility is another focus, and in practice a lot of interruptions occur due to a lack of automation. Many companies lack a homogeneous infrastructure and may be using multiple ERP instances, resulting in inefficiencies. The solution is to achieve the end-to-end optimisation of digital processes, from e-invoicing to the integration of ERP systems, and to build overarching solutions that provide enhanced data visibility.
- **Working capital/sourcing** – while companies may be able to improve their working capital by extending the payment terms offered to suppliers, Mutter notes that those payment terms "really should be fair – I think there's a rethinking in some businesses as to what fair payment terms are." And where sourcing is concerned, Mutter says companies are increasingly looking at pre-payments to ensure they can source the raw materials they need.

At the same time, efforts to optimise working capital are being driven not only by the need to stabilise supply chains, but also by a focus on business growth as companies navigate a return to more normal economic patterns. As well as seeking to grow organically, many companies are focusing on inorganic growth opportunities in today's buoyant M&A market.

"There's always some degree of consolidation going on, but post-pandemic we are seeing more than usual," says Mutter. "And corporates want to be prepared so that they can act if they see an opportunity." He adds that this often means financing deals using the company's liquidity – which again is driving a renewed focus on working capital.

Supply chain solutions

For companies looking to address the challenges brought by globalisation and changing customer demand, technology has an increasingly important role to play in making supply chains more flexible and efficient. While technology investment can often slow down in uncertain economic environments, this has not been the case during the pandemic: in late 2020, a survey of 200 senior-level supply chain executives by Ernst & Young found that 92% did not halt their technology investments.

And in today's market, there is a wide range of supply chain solutions available to help companies solve a wide range of challenges. Taulia, for example, is a holistic working capital platform, with solutions including accounts payable: dynamic discounting and supply chain finance, accounts receivable and inventory management solutions.

Different industries may have different strategies when it comes to adopting supply chain solutions. "Particularly in the retail sector, we see ESG as a top priority," says Mutter. "On the automotive side, we see a lot of collaboration with suppliers: OEMs are looking for supplier health rescue programmes to really understand how they can help suppliers if needed."

Flexibility, liquidity, sustainability

Whatever the core goals, says Mutter, many companies are focusing on building a technology infrastructure that enables them to have a well-organised and documented method of paying suppliers early. Often companies choose to offer their suppliers flexible terms, meaning that suppliers can either receive payment on the agreed value date, or can take the option to receive early payment on pre-agreed terms. "Even industries that have historically not been keen to look into early payment programmes are now starting to investigate what this means for them," Mutter adds.

During the pandemic, Mutter argues that supply chain finance has been proven to be a critical tool for supporting global ecosystems, and has played a key role in injecting liquidity into supply chains when needed. By incentivising suppliers for good behaviour, it can also help companies achieve their ESG objectives: Mutter cites the example of Taulia's client Bridgestone, which decided to offer suppliers preferential early payment financing rates based on the ESG rating of individual suppliers. "The better the rating, the greater the discount – so suppliers have the incentive to work on an enhanced sustainability rating," he explains.

Looking further ahead, Mutter notes that inner city logistics is likely to be a greater area of focus. He cites Switzerland's Cargo sous terrain (CST) project which aims to connect production and logistics sites with urban centres using electric autonomous vehicles travelling on an underground network.

"I think this is an opportunity to think bigger – how can we connect the last mile going forward? And how can we build more stable logistics in the suburbs?" says Mutter. "A lot of thinking, and a lot of investment, is going in this direction, and digitisation will play an important role in automating this." Consequently, he says, Taulia is looking closely at this type of innovative project, "and at how we can intelligently customise our financing to these changed supply chains." ■

Taulia is a leading fintech provider of working capital management solutions and helps companies access liquidity tied up in their payables, receivables and inventory.

For more information, please visit **Taulia.com**

Digital assets promise opportunity beyond bitcoin

So far, the treasury interest in digital assets has focused on investing, and mostly in bitcoin. Now, however, attention is turning to other kinds of digital assets and not just for investing; they have the potential to transform how treasuries – if not whole businesses – are run.

Legendary rocker Rod Stewart once gave Elton John a fridge for Christmas. Not any old fridge, mind you, but the latest one at the time. He'd spent £600 on it – which was a lot back in the 1970s – but when his fellow musician reciprocated with his gift, it paled in comparison. "He gave me a Rembrandt painting! I've never felt so stingy," Stewart reportedly said.

Now in the era of digital assets, such a mismatch in generosity could be solved with tokenisation. Now you could buy a portion – the equivalent of £600's worth – of the painting and make an illiquid asset easily tradeable. Or perhaps you want to do away with physical paintings and venture into the world of digital art. A non-fungible token (NFT) of Melania Trump's eyes, a digital watercolour that is selling for 1 Solana (approximately US$180), perhaps? This seems like a bargain when compared to 'Everydays – The First 5,000 Days' by Beeple, a collage of 5,000 digital images that sold for US$69m at Christie's in March 2021.

When it comes to digital assets, treasurers aren't looking to the art world for their investment strategy, but they are considering other types. "People are being cautious, but at the same time they are also curious about this asset class," says Manoj Ramachandran, Principal of Digital Assets at BNY Mellon.

The US-based bank has got involved in this space – with its Digital Assets unit – in response to client demand. Also, Ramachandran says, "the timing is right" because there is now greater clarity around the custody of digital assets. And there is also an emerging ecosystem of fintech providers that can support the development of various digital asset products.

"I would not say everyone is thinking about it – they are at the very early stage with their allocation of this asset class," says Ramachandran. "I think it will be a few years until this is mainstream from a corporate treasury perspective," he adds.

So far, the interest has been mostly on investing in cryptocurrencies, and Ramachandran notes that corporate treasurers became more interested after seeing companies like Tesla and MicroStrategy investing in bitcoin.

Anatoly Crachilov, Founding Partner and CEO at Nickel Digital Asset Management, comments that it is natural – given the nature of their business – for treasurers to be conservative when it comes to digital assets. "They have to be mindful of liquidity," he says. If it is their first foray into investing in digital assets, they are most likely to venture into crypto and its most liquid asset: bitcoin.

Such an investment is increasingly being considered by corporate treasurers. For example, Nickel Digital Asset Management found in December 2021 that growing numbers of listed companies were investing in bitcoin. Their analysis revealed that 20 listed companies with a market capitalisation of over US$1trn have approximately US$9.3bn invested in bitcoin, after originally spending US$5.8bn. Geographically, the bulk of these companies – 13 out of 20 – were in the US or Canada.

For many, an investment in bitcoin makes sense for a treasurer's portfolio. In a previous interview with Treasury Today, Brad Yasar, Founder and CEO of EQIFI, had something of a rallying cry of "Buy bitcoin!!" Even for those who aren't believers in the cryptocurrency, he argues, they should think of an investment in bitcoin as an insurance policy.

Crachilov makes a similar case for investing in bitcoin for treasurers who may still be reluctant: if you allocate a small portion – 1% – the upside can still be significant, without being too exposed to the volatility. "Sizing matters," says Crachilov, when it comes to a bitcoin allocation. He illustrates by comparing a traditional investment portfolio of 40% bonds and 60% equities, which are invested in the S&P500, to a portfolio that includes 1% and 59% equities. He tracks their performance over a nearly nine-year period from 31st December 2012 to 30th September 2021.

The traditional 40/60 portfolio had a cumulative total return of 144.3% (annualised return of 10.4%) over that period, an annualised risk standard deviation of 9.8%, and the maximum drop – or drawdown – was 21.6%. If the portfolio is adjusted to include 1% bitcoin, the cumulative total return increases to 170.8%, the risk is 9.9% (not much of an increase), and the maximum drawdown remains the same. This drop is the same because the biggest decline was in March 2020 when there was a sell-off because of Covid. Crachilov argues that a treasurer could enhance their portfolio by including bitcoin – an uncorrelated asset class – because historically it has behaved differently from the equities market.

If a treasurer is feeling braver and increases their bitcoin holdings to 3% there would be a cumulative total return of

232.2% – a much larger figure – but the risk increases to 10.1%. At this point Crachilov says, "The benefit outweighs the risk – that is the beauty of this." However, he notes, as you allocate more and more crypto, "At some stage it is way too risky – a single digit allocation makes perfect sense," he adds.

Also, Crachilov argues that bitcoin has a role to play in an investment strategy if you are looking to protect against currency debasement, where the value of the currency is lowered. He points to the figures for the M2 money supply, which increased by 28% between December 2019 and December 2020 to US$19.5trn as part of the US pandemic stimulus. The only other time the M2 indicator has been this high, he says, is in 1943 when the US undertook a stimulus programme as part of World War 2. At that time, M2 increased 27%. Initially, the impact of that stimulus had a subdued effect on inflation. However, it came with a three-year delay and by 1946 inflation was 18%.

"Bitcoin is the logical choice" for protecting against this scenario, says Crachilov. Bitcoin has a "non-discretionary immutable monetary policy" which means that no entity can affect its supply. Approximately 90% of bitcoin has been released and the remainder will enter circulation according to a fixed schedule over the next 120 years. Investing in an asset like this provides a hedge against the US dollar becoming devalued, says Crachilov.

And for those who are still reluctant to invest in bitcoin because of its volatility, Crachilov argues that you don't need to be a believer in its value increasing. Instead, you can trade on its nature as a volatile asset and invest without taking a directional view, and rather harness its swings in volatility.

Beyond bitcoin, there are other cryptocurrencies that are of interest, such as Ethereum. This is a more dynamic asset as it is upgraded more regularly. Also, it has a whole infrastructure of smart contracts, and is an interesting investment for those looking to diversify, says Crachilov. And for the more adventurous, there is investing in decentralised finance.

This is the space that Yasar's EQIFI plays in, which is positioning itself a leader in the field, with a single platform for banking, trading and lending for fiat and cryptocurrenices. The defi platform is connected to a regulated bank (EQIBank) so that high-net worth individuals and businesses are able to transfer their digital assets from the platform into the regulated banking system.

Digital assets have many forms, and corporate treasurers' interest is now looking beyond the simple investment strategies of bitcoin or other cryptocurrencies. BNY Mellon's Ramachandran comments that there is demand from treasurers in other assets, such as tokenised cash as well as tokenised bonds.

Also, with offerings like PAX Gold, for example, it is possible to buy gold as a digital asset where one token – on the Ethereum blockchain – corresponds to one ounce of physical gold that is stored securely in a vault.

Tokenisation means that a physical asset can be transformed into parts – tokens – that are digital and can be used as proof of ownership or traded. They can make assets that are typically illiquid, such as property or paintings, more liquid by making it possible to invest in a portion of them. If you need US$50,000 urgently, you could sell off a portion of your home – by dividing it into 50 US$1,000 chunks for example – and allow a new class of investors to benefit from its rise in value. You get the cash you need quickly without having to sell your whole home. And the blockchain can cut out the intermediary, making it possible to do such a transaction without an estate agent or a solicitor.

> People are being cautious, but at the same time they are also curious about this asset class.
>
> Manoj Ramachandran, Principal of Digital Assets, BNY Mellon

Tokenisation has already been trialled in the property sector and a September 2021 study by Hamburg Commercial Bank and the Frankfurt School Blockchain Center (FSBC) found that 41 companies in 17 countries had already started to pilot tokenisation.

Dr Philipp Sandner, Head of the FSBC, comments on how digital assets is a broad class, and can include digital securities so that stocks and shares can be transferred using blockchain technology – which makes it more efficient for trading.

Ramachandran also notes there is interest in tokenised securities. He notes that from a financial assets perspective, any securities instruments have the "potential to leverage distributed ledger technology (DLT) to make the issuance and the transfer process more seamless and transparent – that is driving some of the activity in the market," says Ramachandran.

And aside from the transfer of securities, there are other more ground-breaking uses of the technology. Sandner explains how it is possible for corporations to tokenise industrial assets, such as machines, tractors, planes, or trains. In the past, a company would have probably involved a leasing company so that they could afford to have access to such equipment. Now that model can be revolutionised because of the blockchain technology: it is possible to slice up the asset and offer it to a range of investors. And the asset could be thought of as a profit centre, which is paid for on a per-use basis. Using the internet of things, the machinery could have sensors on it. These connect to the blockchain, which is also linked to a payments engine and accounting software, so a transaction occurs every time it is used. Such a way of doing things has the potential transform how corporate treasurers work, says Sander. "This transforms how they think about the financing of assets," he says.

In this kind of innovation, Sandner says, treasurers have a key role to play. They often underestimate the role they have to play in innovation, he adds. "Blockchain is very often related to finance – this makes the CFOs and the treasurers the people to drive blockchain adoption in companies," he says. For anyone thinking they may be too far behind, Sandner says, don't worry it's not too late – you haven't missed out. "Everyone can be part of this journey." ■

Fighting fire with fire – using a community-based approach to combat payment fraud

As fraudsters are becoming increasingly sophisticated, and sharing data across their criminal networks, treasurers need to do more to protect themselves. By also using data, and a community-based approach, they can 'fight fire with fire' and prevent payment fraud.

Jon Paquette
VP Customer Success, US

Halloween has been and gone this year, but things are still scary out there. Scary for treasurers when it comes to cybercrime, that is. The threats are rising: fraudsters are more sophisticated, they are better connected, and they are launching more attacks. In the face of these ever-increasing dangers, treasurers need to up their game and raise their defences to the next level.

The attacks are becoming more automated, making it easier for fraudsters to launch large volumes of attacks more quickly, explains Jon Paquette, VP Customer Success, US at Treasury

> We conducted a partner survey and we found that the actual losses from BEC attacks have doubled over a two-year period. So even though there is greater awareness of these attacks, the success rates are still double. That's a really scary thing for treasurers.

Intelligence Solutions (TIS). Also, they are using more information – which may be publicly available – to make their approaches to potential victims look more genuine. If they know the habits, routines and work processes of their potential targets, they can get inside the heads of their victims and know how to trick them into doing something that bypasses the usual controls that are in place at their organisation. And the more information they have, the easier it is to do.

Access to data

These days, fraudsters have access to all kinds of information on their target. This could include the systems they are using at work, who they report to, and who signs off on large transactions, for example. This information is big business: it will be shared across criminal networks so that fraudsters can add it to the data they are amassing on potential targets. "Fraudsters are sharing this data to attack organisations in a smarter way and a much more automated way," says Paquette. The attacks are also scaling up, "They are seeing a lot more success in their attacks," he adds.

For corporate treasurers, there are many forms of cybercrime to worry about. Attacks are getting more sophisticated, and using the latest technologies available, but some of the more old-fashioned scams are still working well for them and reaping large rewards. Business email compromise (BEC) scams still abound, even though there is a much greater awareness in the treasury community – and in businesses more broadly – about the nature of these attacks. BEC attacks typically target treasurers, or those who are authorised to make large transfers, and their email accounts may be hacked, or compromised.

Sophisticated attacks

Unlike mass phishing scams, which target individuals indiscriminately, BEC scams are highly-sophisticated 'spear phishing' attacks that target specific individuals who are known to hold the purse strings at large corporations. The fraudsters will lie in wait, choosing the right moment when they know their victim will be fooled into thinking their superior is asking them to make an unusual transfer. The criminals may only proceed when they know the chief executive officer (CEO) is on holiday, with intermittent access to email and no phone reception, for example. So, when the treasurer receives an email from them – the address seems genuine – they think it is natural for the CEO to communicate in this way, it is understandable that the transfer is urgent, and they don't double check because they know the CEO is otherwise uncontactable. They go ahead and make the transfer, not realising they are sending money right into the criminals' hands.

Unfortunately, BEC attacks like this are becoming more commonplace, and Paquette says the figures are getting more alarming. As a former treasury practitioner himself, Paquette comments that he would hear about BEC attacks on a weekly, even daily basis. Now what is different, he says, is the frequency of the losses. "We conducted a partner survey and we found that the actual losses from BEC attacks have doubled over a two-year period. So even though there is greater awareness of these attacks, the success rates are still double. That's a really scary thing for treasurers," says Paquette.

What is also frightening is the use of cutting-edge techniques, such as deepfake technology. With deepfakes, it is possible to take an audio recording and make it seem like someone you know is saying something they haven't actually said. Deepfakes have gained prominence for their use in political disinformation campaigns, and one video made by BuzzFeed in 2018 shows how realistic they can be. The video records actor Jordan Peele speaking, mimicking Barack Obama's voice. His mouth is then merged with a real video of Obama talking. Through the use of artificial intelligence and video editing software, the end result is a video of Obama speaking words he has never spoken. Although this technology is not being used widely in fraud attacks against corporates at the moment, it gives an indication of the kind of threats that are coming.

At a basic level, audio clips of a CEO could be spliced together and left as a voicemail instructing a treasurer to make a large transfer. But as the technology becomes more sophisticated – with natural language processing, artificial intelligence (AI) and machine learning – a bot will be able to learn how to have a natural conversation in the style of the person it is mimicking. This kind of fraud is beginning to hit the headlines. In 2019, there was a case where a CEO's voice was mimicked and a 'fake Johannes' instructed a subordinate to transfer US$240,000 urgently – which they did. It was so realistic the managing director really believed it was their CEO making the request. This voice cloning attack was reportedly the first of its kind, or at least the first attack that has been reported by the media. "This brings the threats to a whole new level," says Paquette of deepfake fraud.

Increasing losses

These new threats also come at a time when cybercrime more generally has been on the rise. Fraudsters have pounced on the change in work patterns – of working from home and more online interactions – due to the COVID-19 pandemic and ensuing lockdowns. In 2020, the Federal Bureau of Investigation's Internet Crime Complaint Center (IC3), received a record number of complaints – an increase of 69% to 791,790

We're seeing instances of supplier accounts being hacked and then the fraudster sending in what looks like a legitimate request to change the instructions.

– from the US public. The reported losses from cybercrime were more than US$4.1bn. And of these losses, the BEC attacks were the costliest. IC3 reports that there were 19,369 BEC-related complaints in 2020, which totalled a loss of approximately US$1.8bn. IC3's Internet Crime Report 2020 also notes that the attacks are becoming more sophisticated and are no longer just targeting the email accounts of CEOs or chief financial officers (CFOs). Now it may be vendor email accounts, or lawyers' accounts, for example, that are being targeted.

This trend of moving downstream from the CEO, CFO or treasurer is also occurring with fake invoice attacks, notes Paquette. In the past, it may have been just the treasurer who was targeted. Now the attacks are being pushed further down an organisation and it may be the procurement or accounts payable teams that are being targeted with fake invoices, he says.

And it's not just the corporate that is being targeted – it could be their suppliers as well. "We're seeing instances of supplier accounts being hacked and then the fraudster sending in what looks like a legitimate request to change the instructions," says Paquette. These attacks can target the users of the enterprise resource planning (ERP) systems – either through hacking or social engineering – and the internal master-data such as beneficiary bank account details are changed. Once these details are changed, the fraudsters can then send legitimate-looking invoices with the new bank account details. The first the supplier hears about it is when they call up to ask why their last few invoices haven't been paid. The corporate thinks they have been paying the supplier; they have been making payments – just into the wrong account. With corporates typically handling thousands of invoices every month, it is impossible to scrutinise the details of every invoice or wire instruction change request. And as their organisations become more complex, larger, and more international, their exposure to this kind of fraud increases exponentially.

Improving detection

So, given these trends of increased BEC losses, greater automation, more scale, more sharing of information among criminals, what can be done in the face of these growing – and worrying – threats? There are two things, says Paquette. "You can prevent it, or you can detect it," he explains. In preventing such fraud, an organisation can invest in all the controls and technology to stop it from happening. However, in the face of the increasing threats, and the growing automation – as well as the increased sophistication of the attacks – it is becoming a lot harder for organisations to prevent everything that comes their way. Awareness of the problems and training to spot attacks is not enough. "The attacks target people and manual processes. The fraudsters are always looking, assuming control gaps are there. And they will find them," says Paquette.

The other approach, explains Paquette, is to detect the fraud and use a safety net for when it does happen. That is where the Payee Community Screening (PCS) tool comes in, which can detect fraud before the payment is actually made. PCS uses a community-based network of trusted beneficiaries, vendors and bank account information so that payment instructions can be referenced against a vast pool of data. This data comes from the payment volumes of existing customers who are using TIS's global payments solution.

The beauty of big data is that as the members and the community grows – and more transaction data is acquired – the more accurate and useful it becomes. PCS uses data from verified transactions that are transmitted by clients through the TIS platform to determine the legitimacy of new payments. As a specialised provider in the global payments space, TIS gives its customers access to over 11,000 banks in over 80 countries. This tremendous reach means that it can potentially identify more than 15 million unique beneficiaries.

The community approach

The PCS solution uses a combination or rule-based and pattern-based technologies to detect anomalies, or flag when payment details could be fraudulent. PCS checks against an organisation's own payment history to detect if beneficiary details have been tampered with. Also, a supplier's bank account details can be checked against the transaction data of other organisations that are also paying them. If a corporate is paying a supplier to an account that does not match what the rest of the community is using, it will be flagged.

Paquette explains that the transaction data from this community of organisations – of differing sizes, industries and geographies – can detect many kinds of abnormalities. With these checks against the community data, it becomes easier to detect fraud and fake invoices. Also, "If someone has identified an account that is being used in fraudulent attacks, that information can be shared across the whole community," says Paquette. By leveraging the community in this way, the criminals can be stopped in their tracks as the other member organisations anticipate and counter these specific attacks.

This community approach is how PCS differentiates itself from other solutions that are available in preventing payment fraud. Rather than solely being focused on technology capabilities and the rules and checks for detecting abnormal transactions, PCS's strength comes from its focus on building the largest dataset possible. The value in the solution, and effectively fighting fraud, explains Paquette, is in the data. "The community data is a game changer," he says.

Paquette gives an example of how community data is different from relying on conventional controls. If a spoofed supplier email is sent from the contact at the supplier – say, John Smith – the check may be to verify that John Smith is the trusted contact at that organisation. They may check, and find that John Smith is indeed the trusted contact, and therefore the request is deemed genuine, and so the bank details get changed. This may not be picked up as problematic if the usual check – of verifying the contact name at the supplier – is relied on. Where the community approach is really powerful, explains Paquette, is that it can detect anomalies. For example, there may be other organisations that also use the same supplier, with the same trusted contact. "With community data you can see within the entire community that 15 other organisations – for example – are all paying this vendor and everyone else is paying using the beneficiary details you previously had in your vendor master before the latest change," explains Paquette. "That is really powerful."

PCS's value is also in its ability to reduce the number of false positives, and it overcomes a typical challenge that many organisations have with managing new solutions. Most organisations, Paquette explains, are concerned with the extra time that is taken up in weeding out the real positives from the false ones. "Having large amounts of data from various sources allows us to get really refined in the screening process, which results in few false positives," says Paquette. "A common concern we have among the organisations that we talk to is about the false positive rate and how much work it will take to administer this tool on a day-to-day basis," he says.

Creating a safety net

Even the best, most robust internal control issues may not be enough in the face of the increasing threats. And PCS is a solution that helps detect fraud, if – or when – it does occur. Even with the best controls, and training programmes in place, given the automation and scale of the attacks – and the persistence and increasing sophistication of fraudsters – organisations are coming under pressure to put a robust safety net in place.

> The control gaps are constantly shifting, and screening needs to stay ahead of that.

In the case of attacks that target procurement, for example, there may be one fraudulent transaction that is buried in a batch of 250 transactions, Paquette says. "There's just no way to detect it without intelligent fraud detection software," he adds. "PCS acts as a safety net." For organisations dealing with increasing volumes, it would be risky for them to not have something in place to detect fraud at the last stage of a transaction: "Without it you really don't have anything to prevent an intrusion by the fraudsters into your procurement, accounts payable, or treasury processes from becoming an actual loss," says Paquette.

> If someone has identified an account that is being used in fraudulent attacks, that information can be shared across the whole community.

Adapting to change

Also, the community-based approach means that the member organisations are staying on top of the latest trends and can adapt to the new threats that are emerging. Any fraud solution needs to be able to respond quickly and be flexible to the changing nature of the threats. "The threats are always changing, organisations are always changing," says Paquette. "Organisations make acquisitions, they take on new systems, they change their banking relationships. The control gaps are constantly shifting, and screening needs to stay ahead of that," adds Paquette.

The PCS solution is always benchmarking against the market, and by analysing the data from the community it can anticipate what kind of attacks could be coming an organisation's way. "It is never a one and done thing for fraud detection," explains Paquette. Another way that TIS is able to stay on top of the latest trends is through its partnership with Deutsche Bank. In March 2021, the German bank announced that it had joined forces with TIS to develop and offer multi-bank services. The cooperation started with developing fraud prevention software for corporate customers and the partnership was established so the two parties could also develop and distribute multi-bank services for treasury and finance. Through this relationship TIS is close to the frontline of what financial institutions are facing in the fight against cybercrime, and this insight informs the development of TIS's products and solutions.

When it comes to developing cyber defences for the future, what will the cybercriminals be doing next? In this arms race between the fraudsters and their potential victims, what threats should corporates be preparing for next? "The truth is we just don't know. And in some instances, I'm not even sure it would matter if we did," says Paquette. He gives the example of BEC fraud, which treasurers are well aware of, and even though there are internal processes and training programmes in place to prevent it, the scams are still successful. The key to preventing payment fraud in the future, explains Paquette is to stay flexible and agile. "It's not necessarily about predicting what is coming next but being prepared for anything," says Paquette. "It is about having the right formula – we think we have that, and it is based on leveraging a foundation of good data," he adds.

The criminals are also sharing this data across their networks, in criminal communities. "It only makes sense for the corporates to use data and communities and automate to defend against them," says Paquette. "It's a fight fire with fire approach to fraud detection," he adds. ■

Treasury professionals sitting tight despite hirer demand

High job vacancy levels across many sectors are reflected in the treasury recruitment sector, where corporates are finding it challenging to fill senior finance roles.

The number of unfilled jobs continues to rise in countries recovering from the worst effects of the pandemic. UK vacancies reached a record high in November, the number of available positions in Japan was at its highest level of the year in October, and even in the US – where job creation figures were below expectations in November – demand remains high for finance professionals. In this context it is hardly surprising that companies are facing considerable challenges in finding the right people for senior roles such as chief financial officer, treasurer or financial director.

At the end of the summer the market was full of vacancies and senior finance leaders were confident about moving jobs. However, as summer passed to autumn potential candidates were thin on the ground – those who had been 'waiting out' the pandemic before they moved had done what they needed to and were now settled in new roles according to Refreshing's Director, Charlie Jones. "Our work now is much more about headhunting and working hard to draw candidates from existing roles," he says. "Responses to job ads are lower and we expect this to reduce further before the end of the year."

Jones says it is not unusual for the best candidates to be considering three or more offers at a time. "There is huge competition to find the most talented people and companies who don't work quickly and carefully consider the packages they are offering will lose out every time," he adds. "Clients who have moved through the worst of the pandemic are ready to hire but until confidence returns and senior finance leaders feel happy enough to leave one stable job for another there will be an imbalance in the market."

Bobby Lane, CEO of professional services consultancy Factotum, reckons it is more difficult than ever to find and attract the right people for senior roles as a result of a trend that was evident even before the pandemic. "The direction of the market pre-Covid was for chief financial officers and finance directors looking to take on a broader commercial role within a business rather than retaining a pure financial focus," he says. "This means that many of those looking to change jobs are not looking to stay as a CFO or finance director but move into chief executive or managing director positions."

Coupled with people taking time to reassess their personal goals and the way that they were working during lockdown, Lane says this has led to a contraction in the talent pool. "There are still people out there, but it is harder to find them and get them through the door," he adds. "Existing employers are aware of the challenges of finding replacements so they are doing all they can to ensure that senior people do not leave, from increasing their salaries and loyalty bonuses to changing working conditions or job roles. Even if someone says 'yes' to you, nothing is guaranteed until they actually walk through the door on day one."

According to Lane, the explosion of start-ups in the technology sector in particular has significantly increased the number of businesses looking for senior team members with financial experience. "There are technical candidates and people with commercial acumen in the market, but finding an all-rounder is not that easy," he says. "There are suitable candidates available for employers who are clear about the role they are offering and realistic about what they are looking for, but the opportunity to work with a technology start up or fast-growing business has been more attractive than entering the profession and training over the last decade."

Emma Ireland, recruitment consultant at Ten Percent Financial, agrees that there are fewer applicants for vacant roles, although she says mid-level positons have proved harder to fill than more senior roles since the end of lockdown. "We see fewer suitable candidates for roles than pre-lockdown in terms of both external applications and expressions of interest from candidates already registered with us," she explains. "This is creating a shortage within the sector and has seen firms struggle to fill the roles they are recruiting for."

Rej Abraham, Managing Director of ABPM, strikes a rather more positive note, suggesting that while potential candidates are fully aware of their value and reluctant to move unless the proposition is commercially appealing, merger and acquisition activity has seen some senior finance leaders enter the job market. On the topic of flexible working, he reckons the majority of CFOs/finance directors still anticipate spending most if not all of their time in the office while accepting that their teams don't necessarily need to do the same. "The e-commerce, healthcare, logistics, homewares, construction and IT services and technology sectors have been notably active and there is a bias for recruiting from similar sectors," says Abraham. "Competition is particularly noticeable where organisations are competing for finance professionals from their own sector."

With a reduction in candidate numbers there is always going to be pressure on companies to offer as much as they can in terms of salary and improved working conditions. Unlike Abraham, Jones says candidates now assume that finance roles will allow for working from home at least two or three days a week and that any company demanding more time in the office than this is at a huge disadvantage.

"Salaries at newly qualified levels are up by 10% or more in the past six months," he adds. "Those at the most senior levels

have also seen their salaries rise, but to attract the best people companies are having to think more about the full package – bonuses and equity are less of a 'nice to have' than they were."

Ireland also refers to increased demand for remote working roles, stating that for many this is now a non-negotiable factor. "For some, concerns about the pandemic are the reason stated for this, while for others it is a question of work-life balance," she explains. "In many cases candidates are prepared to accept a lower salary if remote working is offered. But while working from home has become more common over the past two years some firms are still resistant to the idea, which can make recruiting more of a challenge."

Lane agrees that the pandemic has prompted a reassessment of career objectives for many senior finance professionals. "The global experiment in home working gave them a real insight into what their work-life balance could look like," he says. "I have spoken with a number of senior finance professionals who have subsequently decided that they would take lower paid roles in order to be able to work from home more often and not face the daily commute."

Lane echoes Ireland's observation that employers that do not offer flexibility are significantly reducing their chances of attracting the best talent. To make their task even harder, he says companies may also have to accept the need to pay higher salaries to tempt the right people away from their existing employers. Looking further ahead, Lane reckons the disparity between supply and demand for candidates with both technical and commercial skills will ease over the course of this decade.

"In recent years there has been a resurgence in people entering the profession and training to be a finance professional, so there will be a new wave of commercially minded, well-rounded finance professionals for the future," he concludes. "However, this does not help the current position so employers have to recognise the challenges that they will face as post-lockdown, candidates may be happy to stay where they are or look for a total change of direction." ■

CASE STUDY

One of the obvious challenges in recruiting staff during a pandemic is meeting potential candidates in person rather than virtually.

"Fortunately the restrictions had been eased by the time we started the process so we were able to see quite a few people in person, but that might not be possible in the coming months," says Amrit Chandan, CEO of clean tech company Aceleron, which recently recruited its first CFO through ABPM. "It is also important that the candidates are comfortable meeting this way."

Because of the early stage nature of the business, Chandan was looking for someone with experience of venture fundraising as well as operational experience. "We promote a flexible working culture but for such a senior role it is vital that there is a willingness to get stuck in and do what is needed, including travel because some meetings are too important to do online," he adds.

Chandan says he receives a large number of requests to connect on LinkedIn from recruiters looking to place people in the company on an ongoing basis, which he describes as "tiresome" when he is not looking to fill a specific role. The recruitment process for the CFO role started at the end of the summer and the chosen candidate was signed up in the second week of December. "We spoke to around a dozen people and my priority was to ascertain how they might fit into the business and whether they inspired confidence that they could do want I – and the business – need them to do," explains Chandan. "Some of those we met had the potential to grow into the role, but just didn't have the skills and experience we require right now."

The company has a strategy of paying the market rate for new recruits, although Chandan says anyone looking primarily at the remuneration would not have been seriously considered. "For such a senior role we encourage working in person at least initially while the person is learning the ropes, but beyond that we enable staff to work around school runs and important life events," he adds.

CASE STUDY

According to Nick Woodward, Group CEO of recruitment software vendor ETZ Group – which took on an executive financial director/CFO earlier this year – the biggest challenge in the recruitment process continues to be finding people with integrity. "We have talked to a lot of people who claimed to have certain skills and experience that they simply didn't have," he says. "Then you try to find candidates with real world business experience, people who have done something entrepreneurial or sales focused – and because the UK economy has become dominated by the service sector the pipeline of this type of candidate is drying up."

The company's latest recruit was found after a search that lasted around three weeks and was assisted by Ten Percent Financial. "We didn't have as many options as we expected, although the candidates were all good quality," says Woodward. "In terms of salary and working conditions, candidates want to be able to work from home – it is very hard to attract people if you make them come to an office when the work can be done equally well remotely."

A NEW ERA BECKONS AS ISO 20022 GATHERS PACE

As the adoption of the ISO 20022 standard gathers pace for payments around the world, corporate treasurers would do well to think beyond the immediate benefits for them, and for financial institutions, and consider the numerous innovations it could bring.

Working out what a payment is for is not always easy. We've all been there: maybe you look at the bank statement, then click for more information, or maybe you need to rummage through some other documents.

Those days should be over once ISO 20022 becomes a global standard for payments. Although the messaging standard has been around for more than 15 years, its adoption is now set to gather pace and soon become the de facto standard worldwide for high-value payments.

At a simple level, ISO 20022 means that all the parties in the payments chain are talking the same language, explains Edward Ireland, Senior Market Development Manager at Bottomline Technologies. Also, the standard increases the quality and amount of data that can accompany a payment. It can also bring visibility on what payments are for, and efficiencies in operational processes. "So many times you have to go back to find out why this payment has been made," Ireland comments.

Typically, payment data has only been the account number, the amount, and the name, but now a lot more will be possible. Invoices could be referred to. Or with a car sale, for example, the vehicle registration and road tax documents could accompany the transaction. "That then means you have transaction information and not payment information," says Ireland.

A trade finance transaction could carry a link to a portal where you could view all the relevant documentation, comments Ireland. Or a house sale could carry data about the 'purpose of funds', the type of property it is, or even the title deeds. If used to its full potential, the messaging could help fight against fraud and money laundering, or if used innovatively, could improve customer experience.

Ireland notes the standard has been around for a while, but a number of recent moves have accelerated its path from local systems to global cross-border adoption. For the business case to be realised, it had to be an industry-wide initiative – and that is what is now taking shape.

For example, the Bank of England is moving to the standard with the renewal of its real-time gross settlement system (RTGS). And so is the European Central Bank's TARGET2 and the Federal Reserve's Fedwire. With this, and the countries that already use it – such as China and India – a global standard is emerging. This will be given a further boost with SWIFT's move to the standard for its messages by November 2025. "That then impacts everybody in the cross-border space," explains Ireland.

This standardisation will drive efficiencies and create opportunities for corporates. And according to SWIFT, it will drive progress in new business innovation, cost optimisation through automation, enhanced customer experience, and regulatory compliance.

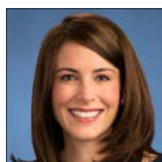
In the first instance, the transactions on the Bank of England's RTGS from June 2022 will be 'like for like' – the transactions will be the same but in a new format. And from February 2023 the central bank will transition to the enhanced messaging, and from Spring 2024 will mandate purpose codes and Legal Entity Identifiers for certain high-value payments. Being able to identify the names and addresses of beneficiaries has an immediate processing benefit, comments Ireland, as it was not previously possible to identify all the parties in the payment chain.

For now, the impact for corporate treasurers is likely to be indirect, but they will have to respond to their banks when they ask for additional information during the transition. In the future, however, more innovation will be possible as it becomes the dominant standard worldwide. And you won't have to look up what that payment was for ever again. ■

SMA demystification: liquidity, flexibility and yield

In a recent webinar, a panel of experts discussed how Separately Managed Accounts have evolved to offer corporate treasury teams bespoke cash management strategies that combine yield, liquidity, tilted ESG exposure and hands-on asset management expertise.

Will Nossier
Director of Group Treasury
Booking.com



Lauren Oakes
Global Co-Head of Liquidity Solutions Client Business
Goldman Sachs Asset Management

Damien Cahill
Sales Director, EMEA Corporate division
Clearwater Analytics

Separately Managed Accounts (SMAs) have a reputation for complexity, but an increasing number of treasury teams are opting to invest in these bespoke vehicles. Speaking in a recent webinar, Lauren Oakes, Global Co-Head of Liquidity Solutions Client Business at Goldman Sachs Asset Management, Damien Cahill, Sales Director, EMEA Corporate Division at Clearwater Analytics and Will Nossier, Director of Group Treasury at Booking.com, leading global travel platform, explained how SMAs have evolved to offer treasury teams customisable liquidity solutions.

Evolution

One of the key reasons behind growing SMA take-up is market evolution. Corporate allocations to traditional MMFs have ballooned during the last decade, creating a launch pad from which treasury can confidently allocate to next-step SMAs. SMA use is also growing as more corporates, led by US treasury teams, hunt for yield on their cash in a low rate environment and consider bespoke exposure, especially on relating to ESG.

Today SMAs comprise of key pillars in a simplified product offering, explains Oakes. Custodians offer standardised paperwork for set up simplifying the onboarding process; asset managers like Goldman Sachs focus on providing the investment expertise and market access while partnerships with service providers like Clearwater Analytics have changed backend reporting, introducing the ability to monitor SMAs daily with on-demand performance analysis.

"The management of relationships, multiple agreements and the operational undertaking has historically put investors off the product," says Cahill, explaining that Clearwater as a SaaS solution can remove the administrative and IT burden for treasury teams by working with its library of connections and custodians, asset managers, treasury management systems and enterprise resource planning applications. Typical onboarding time is four to six weeks. The Clearwater team take care of the data migration, including the coding of the chart of accounts, and can support multiple currencies and bases, as well as regulatory reporting such as IFRS9 and Solvency II.

SMAs differ from MMFs in some key areas, says Oakes. Assets in the SMA are owned outright by the investor; the investor chooses a manager to execute on specific objectives, benchmarks and timeframes and can opt for expertise around, for example, ESG alignment or currencies.

Education

Demand for SMAs has also grown with treasurers' knowledge of the product. Treasury teams are better informed of the flexibility SMAs offer around the size of vehicle, and no longer view them simply as a high-yield product for longer-term cash allocations. Treasury teams are more aware that different maturity ladders of SMAs can ensure a constant flow of cash for withdrawal or reinvestment in an SMA: money can be available in just a few days and compliment any programme run in-house. An investor's objectives are written into the Investment Management Agreement (IMA) by the investor and manager, customised to a specific mandate.

IMA

Putting in place an IMA had its challenges when Booking.com began using SMAs, explains Nossier. However, the process was smoothed by the firm's asset manager being on-hand to help set the risk profile, eligible assets and any specialist portfolio requirements for the company. Asset managers shape a bespoke balance sheet strategy around clients' cash usage which informs allocations to issuers, sectors and decisions around credit quality, duration, and yield within the SMA, he says.

Treasury teams also need to think about restriction lists or parts of the policy that are a little more actively managed depending on a corporate's evolving strategy. "It all ties back to the flexibility you can build into your SMA," says Nossier.

Having the proper governance was also essential. It is why using tools offered by providers like Clearwater is helpful. Once a rules engine has been configured, alerts can be triggered upon detection of portfolio breaches which is useful for audit purposes.

Nossier concluded that the SMA structure allowed his treasury team to call on its asset manager during market turmoil in March 2020. "Back then it would have been challenging competing with institutional trading desks when attempting to sell positions," he says. Fast forward to today's potential rising rate environment and that relationship is just as important as the company seeks to align its SMA exposure with its conservative risk profile, drawing on hypothetical portfolio models and macro analysis proved by its asset manager. ■

If you missed the webinar and would like to hear the full recording, this is available at ***treasurytoday.com/webinars***

China's money market fund landscape

What does China's money market fund landscape look like today, and what developments are likely in 2022?

Aidan Shevlin
Head of International Liquidity Fund Management
J.P. Morgan Asset Management

The Chinese money market interest rate landscape has rotated substantially in 2021 as investors grappled with the implications of slower economic growth and the PBOC's reluctant monetary policy pivot. Concurrently, money market funds (MMFs) witnessed strong inflows, despite increased competition from new products. In 2022, lower interest rates, a focus on climate change and the implications of looming asset management product rule changes will create challenges and opportunities for Chinese MMFs.

The interest rate pivot

From robust growth at the start of 2021, multiple factors negatively impacted the Chinese economy, translating a gradual slowdown into a sharp decline. The government's commitment to deleveraging the property and shadow banking sectors, combined with Delta variant outbreaks, all magnified economic volatility and prompted expectations of fiscal and monetary policy easing.

Initially, hawkish PBOC comments pushed SHIBOR yields to year-to-date peaks in February. However, by the mid-year, the PBOC pivoted to neutral and then most recently a dovish policy stance. The central bank cut the Reserve Requirement Ratio twice; on both occasions it was foreshadowed by calls by Premier Li for monetary support for the real economy.

Anticipating these cuts, SHIBOR yields declined and the curve flattened throughout the remainder of 2021. The PBOC also focused on maintaining adequate liquidity, ensuring that repo rates were much more stable than in 2020. However, escalating property-related risks continued to negatively impact onshore credit spreads, which surged higher in the second half of 2021.

MMFs with long duration positions outperformed, but heightened expectations of additional monetary policy rate cuts next year have diminished the longer-term outlook for MMF yields. Given their focus on high quality investments, MMFs, especially triple-A rated funds, remained insulated from higher credit risks – although credit markets are likely to remain volatile in 2022.

The evolving asset management industry

Mutual fund assets under management (AUM) jumped to a new record high of CNY24trn, up 34% year-over-year (as at end Q321). While this was impressive, mutual funds still only represent 10% of the total bank deposits base (~CNY230trn) – although they have caught up on bank wealth management products (~CNY27trn).

In absolute terms, the biggest increase was in MMFs, which jumped 29% year-over-year to a new record high of 9.4 trillion – a strong rebound following declines in 2019 and 2020. MMFs still represent the largest asset class with 39% of total AUM, although this has continued to trend downwards from a peak of 67% in Q318 as other asset classes, have grown faster.

MMFs utilised by e-wallets continued to dominate, representing 49% of total MMF AUM – interestingly, these are now more diversified as regulatory concerns translated into more fund choice across these platforms. Institutional demand also remained strong, representing 38% of AUM, although the number of triple-A funds was unchanged – AUM growth was also robust as multinational corporations and large local institutional investors sought MMFs with good liquidity and security.

These growth trends are likely to persist in 2022 as ongoing pandemic and economic uncertainty encourage renminbi retail and institutional investors to hold elevated cash balances.

New rules, new competition

China's Asset Management Product (AMP) Rules will finally come into force at the end of 2020 after a one-year delay. Originally announced in April 2018, the rules represent the most significant change to how China regulates its shadow banking sector since inception.

The new rules require banks to take their wealth management products (WMP) back on balance sheet, convert them to mark-to-market and, importantly, no longer guarantee returns. By the end of 2020, WMP outstanding had declined sharply as banks repackaged and resold these products via their new asset management companies, and this trend will continue into 2022.

Aside from the competition posed by new NAV-style asset management products, MMFs will also face challenges from new mutual fund products, including NCD Index Funds and ultra-short duration funds, offering different characteristics and features. The authority's prioritisation of ESG factors, especially climate change and a focus on carbon neutrality, have likewise started impacting security issuance, fund developments and investor requirements.

Nevertheless, attractive returns, ease of use, high liquidity and good credit quality should help MMFs maintain growth momentum into 2022.

Yuanyuan Li

Head of fixed income HSBC Jintrust, Fund Manager
HSBC Jintrust Money Market Fund

What does China's money market fund look like today?

Since renminbi money market funds were first introduced in mainland China in 2004, the sector has been growing in both size and significance.

As of November 2021, there were 330 registered MMFs in mainland China, with RMB9.4trn in (AUM), representing around 38.77% of all types of asset AUMs. The MMFs serves as an intermediary between borrowers seeking short-term funding and investors searching for a low-risk cash management solution. MMFs play a very vital role in short-term, fixed income capital markets.

While there is a large number of MMFs in mainland China, the industry is concentrated. The top ten funds concentration has decreased gradually since 2013: the top ten funds accounted for over 64.20% of assets in 2013, but the figure was 24.77% by the end of November 2021.

In the past, retail investors preferred wealth management products and bank deposits, whereas institutional investors were limited to products offered by banks. After the introduction of MMFs, while retail investors welcomed this product, they seldom pay attention to the risk control of MMFs. As for institutional investors, they are more interested in MMFs for their higher safety margin nature, as well as their high liquidity and market yield characteristics.

The rapid growth of MMFs in the market has sped up regulatory tightening. In 2017, CSRC published regulatory requirements for all the open-ended mutual funds, and also imposed stricter regulatory requirements on MMFs such as WAM and WAL, single asset investment limitation, credit quality, single entity exposure etc, which aimed to reduce the financial disintermediation and increase the stability of China's MMFs.

Benefiting from the rising focus on the safety margin of MMFs in the mainland China market, the fund size of HSBC Jintrust MMF has grown steadily since its inception in 2011. HSBC Jintrust Money Market Fund has a strict risk control process, and is suitable for corporations with RMB surpluses in mainland China. The investment objective is to maintain the low risk and high liquidity of its assets and seek to achieve a yield that is higher than that of its benchmark: RMB seven-day call deposit rate.

What developments are likely in 2022?

In 2021, due to the low interest rate environment, hybrid bond funds which include a certain portion of equity assets, also known as "fixed income plus" products, have become more popular among investors. We believe the trend will continue in 2022.

The performance of the fixed income plus products beat market expectations in 2021. As of October 2021, according to data from Wind, the median performance of hybrid bond fund was 4.2% and bond fund-II was 4.10%, beating the performance of long-term pure bond fund (2.99%) and short-term bond fund (2.67%).

We think this trend will continue in 2022, as 2021 was the last year for transitioning wealth management products from being valued on an amortised-cost basis to a net asset basis. Those investors who focus on lower risk and stable performance will likely turn to invest in fixed income plus products.

As at 3rd December 2021, there are six interbank AAA NCD index funds registered in mainland China. This is the first time that the interbank AAA NCD index has been introduced. The interbank AAA NCD index fund's risk characteristics is in between traditional MMFs and short-term bond funds, with normally a seven-day holding requirement. It provides a new tool for those investors who are risk-averse while seeking a yield return that is a bit higher, as its underlying assets are AAA NCD issued in the mainland China market.

There is a potential risk arising from the mismatch between yield and time under amortised-cost valuation. As such, some regulations are implemented in order to control the usage of the amortised-cost method. The interbank AAA NCD index fund is suitable for those investors who focus more on cash management solutions, and we expect this product is likely to become more popular in 2022. ■

Next question:

"Is cash pooling still an effective and valuable strategy for companies aiming to maximise the availability of capital?"

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Price stability lower on central banks' priority list

It is clear by now that inflation in Europe and the US has risen longer and further than originally expected. The major question is therefore how the central banks should respond to this. But first a few facts:

Low growth and excessively low inflation were particular problems for central banks following the outbreak of the 2008 debt crisis. The debt crisis was solved by vast amounts of monetary and fiscal stimulus and hence even more debt accumulation. However, the combination of low growth and very low inflation makes it difficult to sustain the high debt burden – certainly when low inflation shifts to deflation. The combination of low growth, deflation and massive debt is disastrous for an economy. In order to steer clear of this, central banks sought to create a buffer of high inflation.

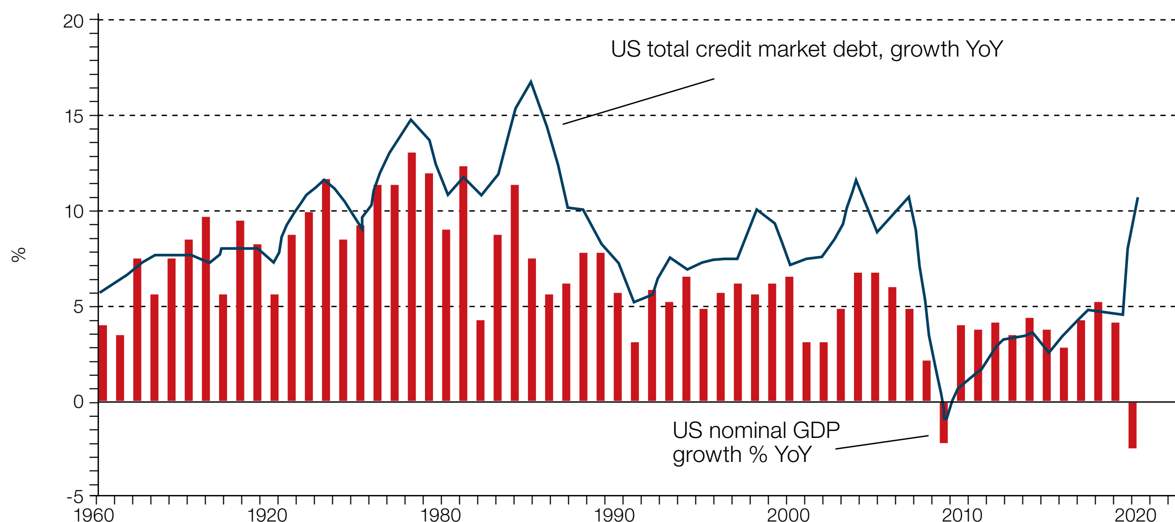
Inflation has now risen considerably compared to recent years. In addition, economic growth has been fairly high of late – both in Europe and the US. A positive growth rate is required as the high debt/GDP ratios mean a recession could easily trigger a credit crunch.

It is striking that newspaper articles generally only mention rate hikes as a means to combat inflation. However, it is economic weakening that depresses inflation – rather than higher interest rates. In other words, it is about raising (real) interest rates until economic growth falls back considerably. However, central banks are currently wary of hitting the monetary brakes too hard due to the risk of another credit crunch.

But what if interest rates are not raised, or only to a limited extent? Under normal circumstances, long-term interest rates are approximately at the level of nominal economic growth. There is no doubt that the soaring debt levels ensure that the economy is slowed down at a lower rate of interest than before. US growth, for example, is currently around 4%, while inflation is at around 6%. Normally, long-term interest rates would be around 10% in this case. At this point, however, ten-year interest rates are around 1.5%. This is an ultra-low (negative) level of real interest rates – to the extent where it is bound to stimulate the economy considerably, in spite of the soaring debts. It is therefore quite likely that growth will stay high, and that inflation will rise to higher levels. This may cause bond yields to rise ever more rapidly over time, which is unsustainable in combination with the aforementioned debt piles.

Changes in (real) interest rates affect economic growth with a delay of two to three quarters, while inflation is impacted after four to five quarters. This is very unfavourable in the current situation, as many economists expect inflation to decline in the period ahead. The upward inflationary pressure is largely due to corona and corona measures. The corona crisis has disrupted all manner of supply routes and created bottlenecks in production and in the labour market. However, the expectation is that the spread of corona will be curbed fairly effectively in the coming year, as a result of which the forces that are currently driving inflation will

Chart 1: Rising debt levels have been a huge driver to the US economy in the past decades



Source: Refinitiv Datastream/ECR Research

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diminish in strength if not disappear. Even if this expectation comes true, however, it may well be that wage increases have ended up at far higher levels before then. This could easily trigger a wage-price spiral in a climate with ultra-loose monetary policies and exceedingly high public deficits. This will result in rising rather than declining inflation. If such a wage-price spiral is regarded as a likely risk, interest rates should be raised as soon as possible. Raising interest rates at this point in time entails the risk that the current very high inflation rate might shift to deflation after four to six quarters.

A warning signal from the markets

Central banks will therefore have to manoeuvre very carefully. If they keep interest rates too low, growth and inflation will stay high, with a wage-price spiral becoming far more likely. If, on the other hand, they raise interest rates too much, this could trigger another credit crunch after 12 to 18 months, from which it would be even more difficult to escape compared to the 2008-2009 period – as debts have since risen to far higher levels, and there is far less scope for monetary and fiscal stimulus at this point.

There is another complication. The US has the highest inflation risk at this point. This is clearly less the case in Japan and Europe (for the time being). This means that the Fed will have to be the first central bank to raise its rates – in a climate in which the ECB and the Bank of Japan are keeping their interest rates very low and are still creating vast amounts of surplus money. In this case, a US rate hike would attract a great deal of overseas capital, keeping asset prices high and long-term interest rates low. This means that US interest rates would have to rise considerably in order to prevent the inflow of foreign capital from counteracting the domestic economic slowdown.

Looking at various market signals in mid-December, investors do not seem overly concerned about a further rise in inflation. Gold prices are trading sideways, inflation expectations derived from the TIPS market have declined lately while investors are pricing in a mere two percentage points rate hike in the incoming two years. We draw the following conclusions from these market movements:

- The markets believe that inflation will fall back considerably – even before a wage-price spiral is able to gain momentum.
- The markets believe that a modest rate hike of roughly two percentage points will be enough to keep inflation low. Hence, short-term interest rates have risen of late, while long-term interest rates have declined.

We could also regard the above as a major warning for the Fed: the Fed should definitely not hit the monetary brakes hard, as this would be overdoing it, making a new credit crunch far more likely. What should the Fed do with this warning? What if the markets underestimate the amount of foreign capital flowing into the US in the event of higher interest rates? Or what if the Omicron variant is so dangerous that, for the time being, the supply side of the economy will continue to be hit more than the demand side?

A complex roadmap

Central banks have the challenge of mapping out policies in this uncertain situation. They will postpone the decision to increase interest rates as far as possible. However, this does not mean that they will mark time. For example, the major central banks are scaling back their bond purchases or will do this soon. This policy is far less aggressive compared to rate hikes.

At any rate, central banks are convinced that, in the current circumstances, deflation is disastrous for the economy. This cannot be said of inflation, especially if it does not permanently exceed 5%. It goes without saying that, when mapping out monetary policies, central banks would rather risk excessively high inflation than accept deflation.

This has important consequences for the financial markets. If, for the time being, central banks – and the Fed in particular – stayed behind the curve with regard to inflation, monetary policies would not be really tight. This would be favourable for share prices and gold prices. In addition, short-term interest rates would not rise considerably and real interest rates would stay very negative, while long-term interest rates would come under upward pressure. If, on the other hand, central banks were to crack down on higher inflation, exactly the opposite movements would likely be evident. ■

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