treasurytoday

research | insight | analysis

May/June 2022

Supply chains in crisis

War in Ukraine has exacerbated the supply chain crisis as buyers step up in support of their suppliers.

The Corporate View

David Plimmer

Deputy Group Treasurer

National Express

Will corporates always need banks?

Could corporate treasurers pick and choose their own fintech solutions without needing a one-stop-shop transaction bank?

Treasury Practice

Minimising the pain of treasury integration

Investing

MMF reform is once again on the horizon

Sustainable Treasury

The treasury benefits of the circular economy

Back to Basics

The payments and beneficial ownership quagmire of sanctions

treasuryinsights
research | insight | analysis

STAY CONNECTED

Join your peers in receiving the latest industry intelligence direct to your inbox weekly.

Subscribe now:
insights@treasurytoday.com

treasurytoday.com

treasurytoday

treasurytoday.com
Volume 24/Issue 3
May/June 2022

Publishers
Meg Coates & Sophie Jackson
EA to the Publishers
Sarah Arter
Senior Advisor
John Nicholas
Editorial
Sarah Rundell
Head of Production & Client Delivery
Samantha Collings
Head of Global Projects
Lisa Bigley
Circulation Manager
Sophie Friend
Digital Content Manager
Joanna Smith-Burchnell
Senior Designer
Dawn Ingram

Founder & Director
Angela Berry
Chair
Richard Parkinson

Switchboard	+44 (0)13 0462 9000
Publishing	+44 (0)13 0462 9017
	+44 (0)79 3943 6343
Memberships	+44 (0)13 0462 9013
Advertising	+44 (0)13 0462 9018
Editorial	+44 (0)13 0462 9003
Production	+44 (0)13 0462 9019

Annual Membership Rate £285
memberservices@treasurytoday.com

© Treasury Today ISSN 1466-4224

Treasury Today is published bi-monthly
(6 issues) by Treasury Today Limited
Courtyard Offices • Harnet Street
Sandwich • CT13 9ES • UK

The entire content of this publication is protected by copyright. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means mechanical, electronic, photocopying, recording or otherwise, without the prior written consent of the copyright holders. Every effort has been made to ensure the accuracy of the information contained in this publication, Treasury Today Limited cannot accept liability for inaccuracies that may occur. Where opinion is expressed it is that of the authors and does not necessarily coincide with the editorial views of the publisher or Treasury Today. All information in this magazine is verified to the best of the author's and the publisher's ability. However, Treasury Today does not accept responsibility for any loss arising from reliance on it. No statement is to be considered as a recommendation or solicitation to buy or sell securities or other instruments, or to provide investment, tax or legal advice. Readers should be aware that this publication is not intended to replace the need to obtain professional advice in relation to any topic discussed.

Treasury Today USPS: (USPS 023-387) is published bi-monthly by Treasury Today Limited, Courtyard Offices, Harnet Street, Sandwich, CT13 9ES, UK.

Subscription records are maintained at Treasury Today Limited, Courtyard Offices, Harnet Street, Sandwich, CT13 9ES, UK.

Strength in adversity

Of all the myriad and complex challenges companies face in the current climate, crisis in their supply chains is up there. Companies have struggled to access the key components that go into their products ever since the pandemic closed borders, but the problem is now exacerbated by China locking down several cities to suppress outbreaks of the virus and Russia's invasion of Ukraine. Such is the challenge of shortages, delays and surging costs, a clear split is emerging in corporates' response that signposts winners and losers ahead.

Focusing on the impact of war in Ukraine on supply chains, our Insight and Analysis feature explores how treasury teams are responding. One solution is early payment and robust supply chain finance solutions while re-shoring – another potential trend – brings benefits and challenges. Perhaps our feature on the Circular Economy offers another solution to the supply chain crisis and rocketing commodity prices: companies prepared to invest in new models around reusing and repurposing the key components in their products could come out the winners.

Staying with the crisis in Ukraine, our Back to Basics feature explores the critical role of treasury around sanctions due diligence, especially when it comes to payments and tracking beneficial ownership given the reputational and financial cost of a breach.

In our Technology feature, we explore how fintechs' explosion onto the banking scene has challenged incumbents, particularly in consumer banking. Could the same thing happen in transaction banking, where corporate treasurers pick and choose their own solutions without the need of going to a large one-stop-shop bank? Elsewhere this edition explores the pros and cons of MMFs and in our Question Answered we ask three experts what ISO 20022 means for the payments industry, and how treasury should prepare.

And finally, nominations for our Adam Smith Awards 2022 closed with over 230 submissions from 34 countries. Global corporate names populate every one of the 18 categories, with strong nominations across the board. Our expert panel have begun judging ahead of announcing the winners online at 3:30pm BST on 12th May. Details on how to join the event are on our website.

IN THIS ISSUE

INSIGHT & ANALYSIS 4

Supply chains in crisis: treasury's response

War in Ukraine has exacerbated the supply chain crisis. Expect buyers to step up in support of their suppliers; more nearshoring and the emergence of corporate winners and losers.

TREASURY PRACTICE 6

All together now

M&A requires careful planning to ensure smooth treasury transition.

INVESTING 10

MMF reform: where next?

The pandemic presented MMFs with the first real test they had faced since reforms were introduced. With reform once again on the horizon in the US and Europe, investors now have an opportunity to make their voices heard.

SUSTAINABLE TREASURY 18

Reuse, repair, repurpose and share: the treasury benefits of the circular economy

Companies will struggle to meet their net zero targets unless they adopt a circular approach and reuse, repair and repurpose the components in their supply chains. Elsewhere, new circular models around leasing and subscription could transform sectors from health to fashion.

TREASURY ESSENTIALS

Treasury Insights 9 & 15

Back to Basics 20

Question Answered 22

Market View 24

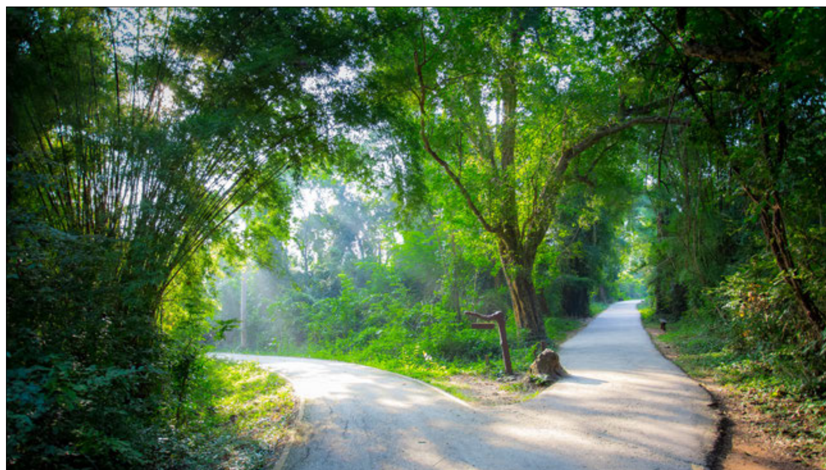
13 The Corporate View

David Plimmer

Deputy Group Treasurer

Global transport group National Express talks hedging, sustainability and bank relationships as the industry emerges from the pandemic.

TECHNOLOGY 16



Will treasury fintech follow the retail path?

Fintechs have exploded onto the banking scene and have been challenging the incumbents, particularly in consumer banking. Could the same thing happen in transaction banking, where corporate treasurers pick and choose their own solutions?

Supply chains in crisis: treasury's response

The semiconductor and auto industries encapsulate the challenges companies face in their supply chains. The ability of companies to access vital components that go into making their products was tested during Covid and has now grown even more complicated because of Russia's invasion of Ukraine. Expect buyers to do more to support their suppliers, more nearshoring and the emergence of corporate winners and losers.

Last year around half of the global supply of neon, the colourless, odourless gas that goes into manufacturing semiconductors, came from Ukraine. A by-product of the steel industry, two companies, Ingas and Cryoin, based in war-ravaged Mariupol and Odessa respectively, supplied semiconductor manufacturers around the world until the Russian invasion disrupted their role in the industry's complex supply chain.

The car industry, which like semiconductors depends on a globalised supply chain where outsourced manufacturing capabilities feed key factories, is also struggling because of the war. Around 17 specialist factories in Ukraine manufacture wiring harnesses used to group and guide the 1km long snake of cables inside a vehicle that form a key part of a car's electrical system. Now disrupted production from Ukraine has impacted European car companies including VW and Porsche's ability to source the vital component. Elsewhere, the food industry is going to have to find alternatives to the tonnes of corn, wheat and oils it sources from Ukraine's breadbasket, and global agriculture will have to turn elsewhere for its fertilisers.

Today's supply chain issues don't come out of the blue. Semiconductor manufacturers begun diversifying their sources of neon after Russia annexed Crimea in 2014, and one of the biggest corporate lessons from the pandemic when borders suddenly shut was around diversifying suppliers, building stock buffers and preparation. However, war in Ukraine has accelerated supply chain risks beyond procurement and logistics divisions, leaving treasury teams playing a pivotal role shoring up supply chain finance programmes by ensuring privileged buyer status, and building capacity as nearshoring and onshoring trends gather steam. "For most companies, the direct impact of the war on their business is limited," says Emmanuel Bulle, Head of EMEA Research at Fitch which estimates only ten to 15 of the 200-odd EMEA corporate issuers it rates have over 25% direct exposure to Russia via sales and EBITDA. "Companies' main exposure is indirectly via their supply chains."

Visibility

Supply chain transparency that extends down the chain to reveal companies' Tier Two and Tier Three suppliers has become key to shoring up production and safeguarding against a hit on revenues. For instance, Ukraine-based suppliers to European auto manufacturers may still be able to service their main clients but their own smaller suppliers may no longer be in business. Visibility is essential to ensure OEMs can accurately assess their requirement for buffers and leeway and understand if supply chain issues will just manifest as a slowdown in production – or require more drastic action like moving production. Visibility of suppliers' payment terms allows treasury teams to see the time lapse between ordering, receiving and payment of those components and gives a window into the financial strength and liquidity of suppliers.

Visibility also plays into another emerging theme: buyer support. With operational payables and receivables data on-hand, companies can delve deeper into their supply chains and wider ecosystems to firm up and stabilise the weakest points with financial support, aware that suppliers favour buyers who are able to provide better terms. Buyers can change payment terms, particularly prepayment, or pay suppliers early. Elsewhere, visibility allows treasury to see if invoices have been approved, and act quickly to pay suppliers rather than let approved invoices sit unpaid in their treasury system.

In another trend, some treasury teams are using surplus liquidity to provide early payments in support of stressed supply chains, notes Alexander Mutter, Managing Director, Head of Enterprises EMEA at Taulia, where research finds supplier demand for early payment has trebled in recent years as suppliers request support accessing liquidity. "Early payments are a way companies can focus their liquidity. Automated processes mean all approved invoices get paid by the buyer earlier and straight through. Or companies can choose to have invoices funded by selecting individual invoices on a fully digitised and integrated working capital platform which can be funded by banks, or the buyers, to bridge the gap in the chain," he says. Having to temporarily adjust payment terms with suppliers was among the top three most effective supply chain finance optimisation strategies, according to a recent quarterly Economist Impact Report.

It is an analysis endorsed by Fitch, where Bulle also notes that large buyers have grown increasingly wary of the risk of smaller, unrated suppliers short on working capital and unable to refinance, impacting their supply chain. Buyers now see

that it can be in their interest to come to the rescue with better payment terms and financial support off the back of their high credit rating, he says. "Large companies' ability and need to support their suppliers is increasingly apparent in our analysis and reviews. We have seen a few large corporates rolling out more supply chain finance programmes in a reflection of the need to support suppliers. If a supplier comes under financial stress, buyers are offering better financing terms."

> Early payments are a way companies can focus their liquidity.
>
> Alexander Mutter, Managing Director, Head of Enterprises EMEA, Taulia

Technological solution

Technology is key to visibility and treasury's ability to support suppliers. It involves centralising accounts payable and receivable (AP and AR) to eliminate duplication across separate locations. Centralisation also improves the business's negotiating position across branches and reduces errors and the risk of missed payments. Effective supply chain management requires overarching dashboards and sweeping business network solutions, adds Mutter. He advises storing information on data and flows alongside raw material pricing and currency and interest rate costs, enabling treasury to manage cash flows and risk together. "Treasury can link their entire network or ecosystem via one platform," he says. "Many treasurers or solution providers only think on a contractual basis or counterparty basis, but treasury should adopt a network approach, mindful of relevant entities on their purchase and sales side and build connectivity to operate as needed."

Elsewhere, treasury teams are using electronic invoicing to facilitate faster finance requests. This solution reduces the time to generate bills, deliver statements and invoices, and resolves any disputes, thereby improving efficiency. International logistics group DHL recently used the e-invoicing services of Tradeshift, a cloudbased digital B2B network and supply-chain management platform to onboard 50% of its vendors within eight months, enabling them to process 21,000 e-invoices per month, up from 12,000-15,000.

Nearshoring

In another trend, the argument for nearshoring is becoming more compelling for treasury. Many industries already reap the benefits of Tier One suppliers, building factories next door to their biggest OEM customer, explains Dominic Tribe, Director, at supply chain consultancy Vendigital. "In the car industry, manufactures build, say, seats on the same day which then go on a conveyer belt into the manufacturing facility," he describes. A jump in the cost of freight plus tariffs and duty, means that manufacturing in China is not necessarily a cheaper option, particularly for companies paying to ship bulky components. Although sourcing certain parts of a supply chain from Asia will remain cheaper – even with rising container shipment costs and tariffs – treasury and procurement teams are increasingly looking at their supply chains on a case-by-case basis, exploring the financial impact of onshoring or nearshoring, says Tribe.

Still, onshoring holds a range of treasury challenges. The costs like labour and overheads may increase if the company moves production to a different country. It will mean treasury teams will need to decide whether they pay their suppliers more going forward, pass the costs onto their customers or if it's preferable to swallow it in their margin.

Nor will it ever be possible to re-shore all production because some components like semiconductors are only manufactured in specific countries – the UK doesn't have any semiconductor manufacturing capability. Other manufacturing processes rely on a highly skilled labour force that is more difficult to relocate than capital equipment. Wiring harnesses are a good example, says Tribe. "They are complex to manufacture, requiring skilled manual labour and when being fitted to vehicles, the weight and size makes them difficult to install and are one of the first components to go into a car once the chassis is built. The process can't be automated and involves skilled labour."

Experts also note that the capital cost of moving production can run into millions, risks duplication and involves unravelling complex ownership rights over assets. Moving production assets requires an asset register to provide clarity on whether the supplier or end customer owns the manufacturing equipment. For example, in the auto sector bespoke tools and processes used by suppliers in the manufacturing process are typically owned by the car companies. "If companies decide to move their supply chains, treasury will need a clear distinction between who owns what asset," says Tribe.

Winners and losers

It is becoming apparent that the evolving supply chain crisis and fundamental challenge to globalisation wrought by Covid and exacerbated for some corporates by war in Ukraine will create winners and losers. For instance, shortages in high-grade nickel sourced from Ukraine and used in electric vehicle batteries is likely to disrupt and lengthen auto groups' road maps to electrification, providing an opportunity for new groups to move into the market. "EV start-up companies like Volta and Arrival could steal market share in the short-run," predicts Tribe. He also believes electric car manufacturers' ability to access semiconductors (each vehicle requires around 3,500 semiconductors and missing just one can thwart the whole assembly) will also create winners and losers. "Semiconductors are not like a screw you can replace," he says. "They are made to specific auto standards and can have controlling safety features – in most cases you can't just swap A with B."

Such is the level of crisis in the supply chain it goes well beyond prices and volatility. Some experts predict it will ultimately force companies to decide whether they can continue to secure the physical goods that go into their manufacturing process or not. "Those prepared best, will cope better," says Taulia's Mutter. "The longer the war in Ukraine goes on the harder the physical supply chain will be hit." Positively, companies are stronger now thanks to cash buffers, balance sheet strength and lessons learnt from the pandemic. The enduring pressure to integrate ESG across supply chains in response to forthcoming legislation, also means that treasury teams are better prepared for the future than they were a few short years ago. ■

All together now

With merger and acquisition activity showing little sign of slowing down, treasury teams need to ensure they are prepared for the challenges of integrating disparate systems and teams.

Market data from PwC suggests 2021 was a record-breaking year for M&A, with the number of deals completed globally rising by almost a quarter (24%) compared to 2020 and deal value increasing by 57% over the same period. One of the main factors behind this growth was portfolio reviews triggering a wave of divestitures across industries as corporate dealmakers seek to reinvest and optimise their assets.

According to PwC, private equity firms were sitting on a record US$2.3trn of capital that was committed to investment but not yet allocated by the end of last year.

Refinitiv reports that between January and March 2022, worldwide M&A activity pushed past US$1trn for the seventh consecutive quarter despite rising geopolitical tensions that are prompting corporate decision makers to consider a 'pause'.

So although higher interest rates, rising inflation, increased taxes and greater regulation could pose structural or financial hurdles for completing deals in 2022, there are likely to be plenty more major deals done over the coming months.

So what does this mean for treasury teams? Damian Glendinning is Chairman of the advisory board at treasury intelligence firm CompleXCountries, which hosts confidential peer discussions where subject matter experts share their approaches to a specific complex treasury problem.

During a call with a member whose company was in the midst of a significant acquisition and wished to benchmark its approach, the difficulty in obtaining information on the acquired entity before the deal closes was highlighted as a consistent challenge that made it difficult to operate effectively from day one.

Suggested solutions included:

- Finding out whether the target entity uses any of the same banks as the acquirer (who may be concerned about potential loss of business).
- Reminding management and HR that payroll cannot be paid unless a banking structure is in place.
- Negotiating with the selling entity for it to continue cash management operations for a period after the deal has closed.

Glendinning notes that participants on the call referred to the importance of clarity on the tax structure and business model as well as IT systems – for example, determining whether the acquired entity will be moved onto the group ERP system.

They also suggested that it was not unheard of for acquired treasury teams to overstate legal and regulatory issues relating to sharing of data to avoid being centralised.

Rhonda Kruman (a consultant in the corporate treasury consulting group for commercial banking at J.P. Morgan who focuses on providing treasury management expertise to clients executing mergers and acquisitions) identifies consolidating online banking portals as an important aspect of integration with a focus on streamlining account visibility and reducing costs.

She recognises that not every company requires full integration of its treasury, payables and receivables processes in its post-acquisition structure and that there may be strategic reasons for keeping functions separate.

Case study

Global financial services provider Apex Group has made more than 20 acquisitions over the last five years, most recently acquiring its FTSE 250 competitor Sanne Group in a deal worth £1.5bn.

The treasury team works closely with corporate finance and the M&A lead at the outset of each proposed acquisition, developing projection models and playing a crucial role in deciding the appropriate financing facility.

Once the transaction has closed, the team moves on to the process of bringing the treasury elements of the newly acquired business – including banking, cash management, hedging, investments and risk management – into the group's programme.

"We have a standard playbook that is applied to every acquired business and starts with getting to grips with its bank accounts and bank account structures and its FX hedging requirements," explains Marcus Worsley, Group Treasurer, Apex Group. "We have a strong focus on working capital management as a business driver so the new entity is brought into our way of managing working capital, which means enhanced collections and billing."

Regardless of the size of the acquired company Apex looks to migrate it onto the main ERP system, although if there is an existing system in place the acquired company may continue to use that for a while as the integration process is completed.

"We have a number of treasury vehicles within the group where all our debt and liquidity and revolving facilities sit, so one of the first things we do is implement automatic cash sweeping," adds Worsley. "We don't hold significant amounts of cash in subsidiary entities."

Treasury has responsibility for all working capital with the group so all of the entity's billing, credit control and payments need to be centralised. The team works with the integration and group finance teams to make sure internal working capital facilities are in place and the accounting structure and reporting structure is mapped onto the group's main ERP and accounting ledger.

In the early stages of a deal the details are communicated to a relatively small number of people, but this group expands once the financing has been confirmed. Worsley explains that the cash management team tends to get brought into these conversations earlier than the billing or payments teams.

"There are numerous meetings to explain how Apex works and how the acquired company team will be onboarded," he adds.

Over the medium term the acquired business is fully integrated into the central billing team and the main ERP and billing system. It is concurrently integrated with the payments and AP team and onto the group's vendor management and PO processing systems in conjunction with the ERP so that policies and procedures are standardised across the group.

"The acquisitions that present unexpected challenges are those where the processes of the acquired company are better than ours, in which case we pick up these processes and embed them within our business," says Worsley. "The billing or cash collection process may be more efficient, or the company may have systems for working capital management that we hadn't considered."

For this reason he believes it is important not to assume that your practices will always be better than those of the companies you acquire.

"When we are doing the due diligence we will look at the KPIs the acquired company is producing and how they compare to our KPIs to see where both entities can do things better," adds Worsley. "We also look at all the processes used from cash matching and reconciliation through billing to credit control."

> Treasury's remit should be defined clearly to understand which activities need to be assessed and how to structure the roles and responsibilities within the new treasury organisation.
>
> Sander de Vries, Director of Treasury, Zanders

Kruman also recommends leveraging banking partners who can offer useful insight into implementation timeframes and functions and provide a treasury point of view to help address considerations of all impacted parties.

"The most important factors to consider when merging or integrating treasury departments are the 'big four' elements that comprise treasury and its operations – policy, process, people and banking," says Adrian Rodgers, Director of treasury consultancy ARC Solutions.

Policies require urgent review and approval by executive management to ensure that they are fit for purpose for the new, merged organisation and reflect its concerns and objectives while processes need to be tailored or re-engineered to ensure they actually reflect and deliver on policy objectives.

"The organisational structure similarly needs to be re-engineered to put appropriately skilled people in the right roles," adds Rodgers. "Finally, the banking structure needs to be updated to eliminate redundancy, fill coverage gaps and support the business needs of the merged group."

According to Sander de Vries, Director of treasury consultancy Zanders, it is crucial to understand the changes in the underlying business and how this translates into the requirements the new entity has with regard to treasury activities.

"Treasury's remit should be defined clearly to understand which activities need to be assessed and how to structure the roles and responsibilities within the new treasury organisation," he says. "Change management is crucial to ensure a smooth transition so it is important to consider the aspect of culture when defining a plan of approach."

Kruman reckons integration represents a unique opportunity for the combined enterprise to evaluate treasury environments and identify synergies across systems, processes and teams. She suggests that by thinking strategically about the future needs of the consolidated business, treasury groups can use the integration period to adopt best practices and introduce efficiencies.

de Vries describes the integration process as an opportunity to further professionalise the treasury organisation and its systems although in practice integration timelines are often short, which means the transformation is system-oriented and processes are adjusted to the system's capabilities.

"Ideally, treasury should invest a bit more time in considering which current processes best fit the new entity and how these can be optimised (for example, by means of automation) to ensure all treasury processes are future proof," he says.

"The challenge is to find C-suite sponsors who can ensure time is spent on a thorough assessment of treasury activities instead of having treasury focus on short-term oriented integration work. Once there is a clear overview of future processes, treasury should assess if the current treasury system landscape is still future proof. A good understanding of market developments and available system capabilities is paramount."

The system challenges are often not related to the increased volumes, but more to the increased complexity and to what extent processes are automated. Treasury should determine how processes fit in the treasury management systems and how the additional company/companies and potentially different ERP systems are mapped to treasury.

"To prevent operational bottlenecks it is vital to assess how processes can be implemented in an automated and efficient way with the right treasury system or systems," adds de Vries.

The integration process is not only an opportunity to review systems and see where improvements could be made but a requirement, since updated policy objectives and re-engineered processes may not sit well with the existing systems architecture says Rodgers.

> The acquisitions that present unexpected challenges are those where the processes of the acquired company are better than ours, in which case we pick up these processes and embed them within our business.
>
> Marcus Worsley, Group Treasurer, Apex Group

"In addition, in many cases both merged entities may have existing systems architectures which need to be replaced by a new harmonised infrastructure," he says. "In the best case scenario one of the entities may have systems which can support the other entity's needs, but even in this instance there are questions and challenges around data cleansing, migration and cutover."

Rodgers says the extent to which treasury management systems are sufficiently scalable to handle an increase in volumes as a result of merger or acquisition depends on the system – and specifically its age and design. "In theory (and often in practice) SaaS provides instant provisioning of resources whereas older, non-SaaS systems may have limitations on storage and throughput, particularly if complex calculations are required," he concludes. ■

SHANGHAI DISRUPTION
THREATENS GLOBAL SUPPLY CHAINS

China's lockdowns and pursuit of a zero Covid policy have caused disruption in and around Shanghai's port – the largest in the world. With congestion and a backlog increasing by the day, the impact on global supply chains – and the economy – could be huge.

Getting goods to – and out of – Shanghai's port has become increasingly difficult as the city has faced Covid lockdowns. Now some are predicting that the 'factory of the world' could come to a complete standstill and global supply chains – which are already stretched – will be severely impacted.

Although some large producers have tried to keep their factories open by using a 'closed loop' system – where the same workers stay together in a Covid bubble – many companies have had to halt production. Electronics maker Foxconn has been operating at 60% capacity, while others have had to suspend production, according to Reuters. The head of Huawei's consumer and auto division's comments in a WeChat post were widely reported in the media: "If Shanghai cannot resume production by May, all of the tech and industrial players who have supply chains in the area will come to a complete halt, especially those in the automotive industry," he said.

For those that have managed to stay open, there are very few truckers available to take the goods from the factory to the port. Drivers have had to stay home because of the lockdown, and some have been stuck on the roads. There are reports of some being stranded by quarantine rules, and there was one news report of a driver who lived in his lorry for seven days because he had visited Shanghai and couldn't travel anywhere afterwards.

The shortage of labour in warehouses, on the roads and at the ports mean that things are getting clogged up. And with supply chains already under stress, this time round the impact could be larger than in previous lockdowns at the beginning of the pandemic. Alex Holmes at Capital Economics in a research note writes that, "There is now a much greater potential for a small bottleneck to have large repercussions."

Back in January, Russell Group estimated that congestion at Shanghai's port was costing an estimated US$4.5bn a week in lost trade. Also, the analysis noted there was US$635m of trade from Shanghai to the United States that was under threat. And things have got worse since then.

Christian Roeloffs, co-founder of logistics company Container xChange, said "Covid-induced lockdowns in China and the Russia-Ukraine war has torn apart the expectations of recovery of the supply chain, which has been grappling to keep up to the pressures of implications resulting from these and many more disruptions."

Economists Alicia Garcia Herrero and Gary Ng at Natixis say the current lockdowns will be especially painful for certain industries: cars, electronics and chipmakers. "When the Chinese economy sneezes, the global supply chain catches a cold," they wrote in a research note. "The situation is particularly alarming for manufacturers in Shanghai, Jiangsu, and Jilin, the key hubs for cars, electronics and semiconductors. The risks of supply chain disruptions can grow if the Yangtze River Delta follows Shanghai in stricter lockdowns, including Anhui, Jiangsu, and Zhejiang," the Natixis research notes.

In the first half of April mobility declined by 92% in Shanghai, the Natixis report notes. The authors continue that in previous lockdowns and electricity shortages, certain industries were prioritised, such as chip production and aimed to reduce disruption as much as possible. Now, however, more companies are halting production. "All in all, Shanghai and the surrounding provinces, namely the Yangtze River Delta, form an important cluster for cars, electronics and chipmakers in China. If the government extends lockdowns, the risk of supply chain disruptions will increase, and firms may use up their inventories," the Natixis report states.

MMF reform: where next?

The Ukraine crisis, inflation and rising interest rates are all affecting the investment landscape. At the same time, money market fund reform is once again on the horizon in the US and Europe – and investors have an opportunity to make their voices heard.

Money market funds (MMFs) continue to be a valuable short-term investment vehicle for corporate treasurers. "When you look at money market funds, they are one of the most regulated financial products globally," explains Paul Przybylski, Head of Product and Strategy – Global Liquidity at J.P. Morgan Asset Management. "They are extremely liquid products, and have a very diversified investor base given the size of the funds. And when it comes to stability, the evidence indicates that money market funds are one of the least volatile types of collective investment schemes out there."

Two years ago, however, the initial phase of the pandemic presented the first real test MMFs had faced since the introduction of new rules following the financial crisis. As a result of the dash for cash, precipitated by the pandemic and the subsequent economic shutdown, MMFs experienced a surge in demand for liquidity from investors.

"Short-term cash markets essentially came to a standstill," Przybylski recalls. "There were very wide spreads between commercial paper (CP) and certificates of deposits (CDs). The banks themselves had limited capacity to intermediate in short-term markets as well, as they sought to shore up liquidity and capital, driven by the regulations that followed the financial crisis of 2008. And investors obviously de-risked, with heavy redemptions across all asset classes."

During the most volatile period of the crisis, Przybylski notes, redemptions on J.P. Morgan Asset Management's platform

reached around 30%. However, this was relatively short-lived: "By the summer, we saw a significant return of the assets into the same exact products, actually breaching highs prior to the crisis of 2020."

MMF reform in the US and Europe

Following the financial crisis, regulators in the US and Europe took steps to increase the resilience of money market funds in the event of future market challenges.

The US Securities and Exchange Commission (SEC) embarked on a programme of reform. The new rules, which came into effect in 2016, saw constant net asset value (CNAV) funds required to switch to a variable net asset value (VNAV) model. Other measures included the introduction of redemption gates to prevent redemptions if weekly liquid assets were to fall below 30% of the fund's total assets, and a 1% redemption fee to be imposed if weekly liquidity falls below 10%.

Europe took a somewhat different direction with its own reforms, which came into effect in 2018-2019. The new rules included the introduction of a new low volatility net asset value (LVNAV) model, to sit alongside VNAV funds and public debt CNAV MMFs. Liquidity fees, redemption gates and suspension of redemptions can be imposed if liquidity falls below 30% and daily net redemptions exceed 10% of the fund's total assets, with mandatory fees and gates applying if liquidity falls below 10%.

Challenges today

Fast forward to 2022, and the landscape has evolved considerably. The conflict in Ukraine has provided another shock to financial markets, with a knock-on impact on the global economy.

"The conflict hasn't had a direct impact on the types of instruments and high-quality issuers that a well-run money fund invests in," says Hugo Parry-Wingfield, EMEA Head of Liquidity Investment Specialists at HSBC Asset Management. "But as with any times of disruption, it leads to some adjustments being made." For example, he says, HSBC Asset Management's funds are currently running with higher-than-normal levels of liquidity – "which is simply a prudent discipline to follow whenever there's any market disruption."

Other notable developments include the prospect of further interest rate hikes, as well as the challenges brought by rising inflation, notes Beccy Milchem, Managing Director – Head of EMEA Cash Management at BlackRock. In addition, she says, few conversations with clients do not touch on the topic of sustainability.

"It's very topical, given the backdrop around the energy crisis that's playing out in markets," Milchem notes. "What we are starting to see is that as investment policies are written, sustainability is front and centre of mind. That goes all the way through from a treasury perspective to cash investing, and what more clients can be doing as short-term investors."

Return of regulatory reform?

The performance of money market funds during the unprecedented stresses of the pandemic have been identified as evidence that the recent regulatory changes have succeeded in their goals. "In our opinion, the rules that money funds have to follow in Europe and elsewhere have generally worked well," says Parry-Wingfield.

Nevertheless, regulatory attention is once again on the agenda. "There's been a particular focus from regulators on both sides of the Atlantic to look at how money funds managed the crisis," Parry-Wingfield notes. "They've been considering whether there are any perceived weaknesses or areas where those rules could be further enhanced to improve the resilience of money funds."

One particular focus is on the value of liquidity fees and redemption gates, which arguably incentivise investors to redeem pre-emptively during times of market stress, in order to avoid being subject to those fees and gates.

In the US, the SEC voted in December 2021 to propose a new round of changes, with the goal of improving the resilience and transparency of MMFs, and reducing the likelihood of future runs on MMFs during periods of stress. The proposed changes include higher liquidity requirements, as well as the removal of liquidity fees and gates. Instead, funds would be required to implement swing pricing arrangements, under which redeeming investors would bear the liquidity costs of redemptions.

In Europe, meanwhile, the EC is already scheduled to review the adequacy of the structures introduced in the 2017 regulation by July 2022. In February, the European Securities and Markets Authority (ESMA) issued a report outlining its opinion on proposed reforms to the regulatory framework for EU MMFs. The proposed measures include decoupling regulatory thresholds from suspensions, gates and redemption fees, as well as other actions such as removing the possibility of using amortised costs for LVNAV MMFs.

Impact of future changes

The question is to what extent further regulatory changes will affect the appeal of money market funds for investors. Przybylski recalls the significant impact of the 2016 US reforms: "As a result of that action, US$1.1trn equivalent of prime assets shifted into government money market funds. The prime space has definitely shrunk – the overall industry is now about US$600bn, from a number that was close to US$1.3trn in the past. So the challenge is regulation that by design limits choice for investors."

In Europe, likewise, industry players are looking closely at the impact of future changes on investors. "The ESMA proposal calls for the ability to round to one to be removed, which would effectively eliminate the LVNAV money market fund – instead, you would end up with a third variable NAV structure," explains BlackRock's Milchem.

She adds that it is only three years since investors spent a considerable amount of time and resources building policies, controls and oversight of the new product structures that were created under the 2017 policy framework. "So we think that corporate treasurers will share our position that a policy response eliminating this structure is not really appropriate,

absent some clear evidence that the structure itself resulted in this vulnerability in March 2020 – which we think is hard to evidence."

Investor voices

While the proposed changes could have significant repercussions if they come to pass, however, this could take some time to materialise. "In terms of where we are at this stage in Europe, it's important for investors to be clear that no rule changes have yet been determined," says Parry-Wingfield. "Secondly, it's still not known when that would be, or what any implementation period would be." He points out that during the previous reform, this was a process that took many years to complete. "So I think it's very important for investors to keep up-to-date with what's going on – but this isn't something that's about to happen in the next few months."

In the meantime, says Parry-Wingfield, it is important that investors take part in the conversation so that their voices are heard – for example, by responding to the European Commission's public consultation, which is open until 13th May.

Milchem, likewise, notes "there is still time to help shape that landscape, and the value placed on the utility of money market funds needs to be conveyed to policy makers. One aim that we at BlackRock have – and I know that the Institutional Money Market Funds Association (IMMFA) has as well – is around bringing investor voices to the table to help influence the debate." ■

Stuart Fitzsimmons
Treasury Manager

WHITBREAD PLC

How does Whitbread use MMFs?

It's part of the toolkit that we have for our surplus cash. At the moment, the options that we use are either bank deposits, savings accounts with the group of banks that provide us with a revolving credit facility, or MMFs. We have a small group of relationship banks, and we have a fairly restrictive treasury policy around how much we can invest with any given counterparty.

We like MMFs because they give us same-day access. We like the yield when we can get it, but it's not our main focus – it really is about security and liquidity, and it enables us to diversify our investments far more than we could do on our own.

How has your use of MMFs changed over the last couple of years?

We've ended up with far more cash, mainly because of things we did to strengthen our balance sheet. In June 2020, the business raised approximately £1bn for a rights issue. Then in early 2021, we went through the bond markets and raised £550m. Some of that was used to retire existing debt, but it also added to the amount of cash on our balance sheet.

We heard about concerns at the time the pandemic started around the possibility of fund liquidity levels and demands on the funds, so we've always kept a close eye on assets under management and liquidity levels. But we haven't used MMFs any differently.

What do you see as the pros and cons of MMFs in today's environment?

The pros are same day liquidity, preservation of capital and diversification of risk. These funds are far better able to diversify the risks than we are – they are invested in several dozen different counterparties and types of instruments, which we wouldn't have the infrastructure to do on our own. They are also very easy to use. When we started out, we were trading over the phone, but now we use the Goldman Sachs Mosaic platform, which is integrated with our treasury management system, Reval. I can't think of any cons – we haven't had any negative experiences with them.

Is the prospect of further MMF regulation on your radar?

Yes, I took part in a round table that one of our MMF providers arranged for corporates with the UK authorities last year. It seems like a long way off, and by that stage our cash balance might have come down considerably. But we are looking at alternatives – I imagine it would be hard for me to get sign-off to invest much, if any, of our cash in VNAV instruments.

The treasury strategy driving National Express

David Plimmer
Deputy Group Treasurer
national express

Global transport group National Express talks hedging, sustainability and bank relationships as the industry emerges from the pandemic.

National Express Group is a British multinational public transport company headquartered in Birmingham, England. It operates bus, coach and train services in the UK and Ireland, United States, Canada, Spain, Morocco, Germany, Bahrain, France, Switzerland and Portugal. It is listed on the LSE and is a constituent of the FTSE 250 Index.

National Express, the global transport operator renowned for its red, white and blue buses driving up and down the UK's motorways, centrally hedges all its fuel exposure from its Birmingham-based treasury operation. In a strategy designed to absorb oil market shocks, the company is 100% hedged for the next year and on a decreasing or rolling basis over the next two years. Although keenly aware of spot prices, monitored daily for their impact on the forward price, the firm is sheltered from today's high oil price triggered by Russia's invasion of Ukraine.

Many transport groups including airlines, cruise lines and hauliers changed their hedging policies during Covid when they were stung by rock bottom oil prices negating all the benefits of hedging, and a collapse in demand for their services as everyone stayed at home. But National Express maintained its hedging policy, run by a busy and multi-skilled treasury team of four who decide how much to hedge according to the forecast volumes from the company's European and North American divisions and which currently amounts to an annual addressable volume of around 200 million litres.

Not only has the approach paid off financially and capped fuel costs at a time oil is over US$100 a barrel, it also highlights the firm's robust treasury policies in another source of quiet satisfaction for Deputy Group Treasurer, David Plimmer. "If you have to always rewrite policy, it's not really fit for purpose in the first place," he says. "It's not our job to spot highs and lows, we run a prudent, board approved treasury policy that outlines limits and controls around hedging our fuel and FX exposure."

The size of the hedging programme offers a window into the bus company's growing, global business that stretches far beyond the UK's road network. National Express runs a North America school bus business under its Durham and Stock brands, swapping the red, white and blue for yellow to ferry children and teenagers to schools and colleges across three Canadian provinces and 33 US states, where it is the second largest player in America's outsourced school bus market. Other US businesses include a transit service in cities, specialist vehicles for the disabled and a fast-growing WeDriveU subsidiary that provides shuttle services for US corporates, universities and hospitals.

Europe is home to other prized parts of the portfolio. A Madrid-based subsidiary, ALSA, operates intercity coaches and regional and urban bus services across Spain; other European bus operations are based in Switzerland and France, and the company owns a German rail operation and a bus company in Bahrain. ALSA's Moroccan subsidiary (the only division that hedges fuel locally because of market restrictions) operates services out of six of the largest cities including Rabat and Casablanca and is one of the fastest-growing parts of the business. "Our Moroccan business actually emerged from Covid bigger than at the beginning of the pandemic," says Plimmer.

It is a startling turnaround for an industry hit harder than most when governments closed schools and discouraged all travel. Although National Express's local divisions run their own cash management and handle local bank relationships, the Birmingham office had to jump into action to shore up the capital structure and guarantee diverse sources of liquidity when passenger numbers and revenues fell off a cliff. Strategies included securing bilateral bank facilities from two of the firm's 16 banks; drawing down a private placement; selling an inaugural £500m hybrid bond and calling on a commercial paper programme. All the while treasury negotiated covenant waivers and amendments with the company's banks and lenders in a fraught process that

required robust communication skills and the ability of the team to step outside their comfort zones. "This wasn't in any of our KPIs at the start of January!" he says.

Today that largesse has left treasury with a surplus to manage and more liquidity on hand than normal. It is currently invested in short-term money market allocations where it is easily tapped for intercompany loans when needed. Money market allocations are spread across the firm's bank group to limit counterparty risk, explains Plimmer. "The yield is nice; we have security of funds and counterparty management. We don't lock funds away as we need to react to different divisional needs."

Liquidity is also a crucial seam to the company's acquisition strategy as it seeks growth opportunities in a road transport industry rife with opportunities in the wake of the pandemic. Plimmer says that the firm is always looking at opportunities across its divisions and seeks to steadily bid and acquire contracts in its North American school bus business as well as expanding its Moroccan and Spanish operations. As and when opportunities arise, treasury will be ready to support, ensuring partner banks have the headroom to provide bid and performance bonds and compliance in the financing documents. Elsewhere, treasury will bring any new acquisitions into the fuel hedging programme and provide access to the company's sizeable vehicle financing programme, he says, "We will make sure we provide whatever is needed."

Treasury oversees 16 relationship banks in partnerships built on good communication, longevity and mutual support. The importance of a quid-pro-quo relationship leads Plimmer to reflect on the company's willingness to support its banking partners in the LIBOR transition. National Express took out a bilateral SONIA loan in 2019 as part of a committed RCF from NatWest's pilot scheme. The transition to new, risk-free rates was beset by unknowns around pricing, technology upgrades and extensive contract updates while bankers and lawyers were also worried whether the new rates would provide a close enough match to manage banks' longer-term liabilities and assets, recalls Plimmer. "We had an opportunity to dip our toe in the water and learn how it works alongside providing important support to our banks."

The company transitioned its remaining LIBOR exposures in 2021 which comprised a £495m RCF and various bilateral facilities. The group didn't have any floating rate derivative exposures that crossed the transition date or longer dated swaps – nor did it have much euro or dollar exposure as most of its borrowing is in sterling. Next, treasury went on to transact early trades for real, including a fixed to floating interest rate swap. "This was our first real test of the systems and processes we had put in place," recalls Plimmer. "It taught us what things needed tweaking and helped us find our feet early on." Although treasury wasn't banging the drum for change, he says the team understood the reasons for a more robust way of calculating borrowing costs. "We are fortunate that we are a large company. It must have been much more difficult for a smaller company."

Sustainability

Now treasury's focus is increasingly honed on a next, much bigger transition ahead: net zero. National Express hasn't issued any sustainable debt yet and Plimmer says the company's next, meaningfully sized financing, will be linked to sustainability KPIs. "We will make sure up and coming funding has an ESG element," he says. It will involve another key role for treasury, particularly helping shape the discussion around which metrics to pick to support the company's 2030 to 2040 net zero targets. Challenges will include the US market for electric school buses compared to the company's UK and Spanish businesses where sustainable policies now include not buying any more diesel buses. Still, he notes that the transport company is intrinsically aligned with reducing society's carbon footprint and has a compelling ESG story to tell investors and banks ahead. "Our strategy is all about getting people out of their cars and into public transport. We are determined to be the cleanest and most efficient transport operator we can be."

Plimmer's belief that treasury should be as comfortable shaping sustainable KPIs as it is running the hedging policy reflects his own varied treasury journey and aversion to pigeon-holing or specialist expertise. After starting as an auditor at PwC where he spent three years, he joined National Express as a Financial Accountant in 2012. A few months later he made Group Treasury Accountant where his strong relationships with the front office team positioned him to jump when a vacancy arose as a Treasury Analyst. His first treasury tasks involved overseeing daily management of the group's cash pool including FX hedging, borrowing and depositing funds, running intercompany funding as well garnering compliance and KYC expertise, he recalls.

Later in the job he learnt to hedge fuel exposures and manage the derivative portfolio, as well as support the company's different divisions access leasing and trade finance. Today his role is broadly strategic and has been particularly focused on securing liquidity through the pandemic where he helped lead the inaugural hybrid bond issue and oversaw the commercial paper programme. New responsibilities which Plimmer says have been facilitated and supported by the Group Treasurer, whose leadership style has become central to treasury culture at the firm. "He really encouraged me to meet banks and build relationships, giving me exposure to the higher-level stuff." Still, Plimmer is more than happy to return to his old stomping grounds when required. "The routine elements of my job have fallen away, but we are a small team, and I can step in when needed."

He is also convinced that the variety of treasury makes for one of the most compelling elements of the job. For instance, following the completion of year end he is now facing a to-do list that spans conducting annual reviews with banking partners and visiting the company's overseas divisions. He's also planning new financing, as well as preparing a high-level strategic overview. All this alongside the routine bread and butter of his day job which currently includes combing through EMTN renewal documents – something he also enjoys. "It's an excuse to get my head into the annual report," he says. "You plan for things but then you have to react to external forces. I love the fact no day is the same."

It leads Plimmer to contemplate the difficulty he has describing treasury to new colleagues beginning their careers – especially in a single sentence. On one hand treasury encompasses routine elements (like spreadsheets) with communication skills and relationships management. On the other it requires reacting to markets and deep dive analysis. The ability to turn your hand to anything, but also stay focused and interact with colleagues, is key to success. "My advice to others? Celebrate the diverse and varied nature of treasury," he concludes. ■

With Citi estimating the metaverse economy will soon be worth trillions, is now the time to get serious about virtual worlds? Or is it all hype? And haven't we been here before with the enthusiasm for Second Life back in the 2000s?

When Facebook rebranded to Meta in October 2021 to focus on bringing "the metaverse to life", many corporates were left scratching their heads and wondering how seriously they should take this brave new virtual world.

Now Meta is testing tools for selling digital assets in the metaverse, and other companies are also piling in. Millions have already visited Nike's virtual store, where they can buy digital trainers. Gucci has already been selling digital versions of its bags and has recently bought land in The Sandbox virtual world. Meanwhile, Microsoft said it was putting the building blocks in place with the acquisition of gaming company Activision Blizzard. And banks are also getting in on the act, with South Korean financial institutions KB and Shinhan, for example, opening virtual branches. Others have also followed, and many more are exploring the opportunities.

Citi recently estimated in a report that the metaverse economy could be worth US$10trn by 2030. And that could be a conservative estimate, according to Ronit Ghose, Global Head of Banking, Fintech and Digital Assets at Citi Global Insights. If a broader definition of the metaverse is used, where it is accessed through personal computers, game consoles and smartphones – not just virtual and augmented reality devices – then the total addressable market could be around US$13trn with up to five billion users.

Citi sees opportunities in various sectors, such as gaming, healthcare, art, advertising and social collaboration. The bank expects that money in the metaverse will have numerous forms, such as in-game tokens, central bank digital currencies and cryptocurrencies.

This metaverse, the next generation of the internet – or Web 3.0 – where users have an immersible experience was originally coined in the 1992 science fiction novel Snow Crash, where it was portrayed as a virtual reality (VR) and augmented reality (AR) version of the internet. So, with all this focus on the metaverse, is it time to get serious about it, or is it all just hype? Or, in the words of Phil Libin, the former CEO of note-taking app Evernote, is the metaverse a "squishscammy word"?

And it's not the first time that a vision for an alternate has been tested. Second Life, for example, was created by Linden Lab back in 2003. One major difference, however, with this and the metaverse, is that Second Life was created as an escape – a world online where people could exist as someone else, roaming around as an avatar living out a different life. The metaverse, by contrast, is both for virtual and augmented reality, where it is possible to live out your current life but with an enhanced experience – think three-dimensional Zoom meetings where it feels like you're actually in a meeting room.

Banks also moved into Second Life in the 2000s by setting up branches, and other companies established a presence there – extending their brand into a new domain. To many observers it seemed like Second Life had died a death, but it has actually continued to operate with more than 60 million registered users, and nearly one million of those are active.

The founder of Second Life, Philip Rosedale says that no one has come close to building a virtual world like Second Life. In January 2022 he rejoined the company as a strategic advisor, giving it a renewed boost. At the time of the announcement, he said, "Big Tech giving away VR headsets and building a metaverse on their ad-driven, behaviour-modification platforms isn't going to create a magical, single digital utopia for everyone. Second Life has managed to create both a positive, enriching experience for its residents — with room for millions more to join — and built a thriving subscription-based business at the same time. Virtual worlds don't need to be dystopias." ■

Will treasury fintech follow the retail path?

Fintechs have exploded onto the banking scene and have been challenging the incumbents, particularly in consumer banking. Could the same thing happen in transaction banking, where corporate treasurers pick and choose their own solutions without the need of going to a large one-stop shop bank?

After visiting a fintech innovation centre in London where start-ups were being incubated, a senior transaction banker had something of a lightbulb moment. They came out saying, "My goodness, these people are going to eat our lunch!"

That was a few years ago, and so far the fintechs have not displaced the large transaction banks; corporate treasurers – although they may have reduced the number of banking relationships – still very much rely on large institutions.

In retail banking, however, the fintechs have been chipping away at the dominance of the largest brands. PayPal, Revolut, Klarna, WeChat Pay and GrabPay are just some of the solutions that consumers are adopting on a mass scale. Instead of going to a bank for all their needs – loans, payments, savings, investments – individuals can pick and choose and manage their financial services from a number of providers. Could the same thing eventually happen with corporate treasurers and treasury fintech innovation? Will corporates always need the one-stop-shop bank to cater to all of their financial needs?

On this question of whether corporate treasurers can do it themselves without a bank, David Blair, Managing Director at Acarate Consulting says, "Technologically, the power of application programming interfaces (APIs) enables what used to be called 'mash-ups' of different services, so the mixing and matching of different best of breed services into cohesive solutions is really doable, and indeed some treasuries are already working in that direction."

Reet Chaudhuri, Co-Lead, Asia Payments for McKinsey, comments that it is necessary to take a nuanced view of the 'fintech vs bank' question because of the range of clients in the corporate banking space. When compared to retail banking, where there are not many differences in the segmentation of customers, transaction banking covers a range of customers that have vastly different needs. At one end of the spectrum are the large multinational corporations (MNCs) with multiple enterprise resource planning (ERP) systems. Then there are the large, single-country corporates, who have sophisticated treasuries and use treasury management systems, but do not have the same scale and complexity of the MNCs. And then there are the small and medium enterprises (SMEs).

Most of the interest in fintech is in select topics such as advanced cash flow forecasting solutions, says Chaudhuri. However, for smaller companies, he says, "They may not have the time or the inclination to make the effort to understand what is the best possible fintech solution for them." The best option for fintechs targeting this segment is to partner with a bank where the solution is a white-labelled or co-branded offering.

And at the larger end of the scale, where multinational corporates do have the resources to scan the fintech landscape themselves, there are still hurdles to overcome. Many of these fintech solutions are cutting-edge, explains Chaudhuri, but they still have to be integrated into older systems. "There have been some challenges with the complexity of these MNCs and multiple ERPs in different countries" says Chaudhuri.

The adoption of fintech has been slow for corporates, especially when compared to the pace of innovation for consumers. Expectations are beginning to change, however. And as many transaction bankers point out, corporate treasurers are also consumers and have come to expect the same user experience they get in their personal lives.

Donald Hoye, Capital One's Head of Specialised Markets, Treasury Management Sales, says that corporate customers are increasingly asking why the experience is not the same as it is for consumer banking. They often say "Why can't I do this, as well?," Hoye says. Capital One, like many other financial institutions, is making a significant investment on bridging that gap and making its treasury and overall business solutions more streamlined and user friendly.

User experience is just one of the expectations that has changed for corporate treasurers. McKinsey notes that in recent years the treasurers' mandate has changed and they are becoming more strategic and they have shifted to 'owning' the full suite of enterprise liquidity instead of a more traditional, narrower role. With this comes a need for solutions that accurately predict liquidity, cash flow and foreign exchange exposures. The 2021 McKinsey Global Payments Report states that the main pain points were in cash forecasting and currency risk, invoice processing and payment reconciliation.

Adopting the latest technology, however, can take time. Blair at Acarate Consulting comments, "Treasurers are a risk averse bunch, and the prospect of different parties passing the buck for problems looms large, so many treasurers prefer to minimise the number of service providers to reduce

operational risk. Banks have been capitalising on such fears to promote their role as curators of fintech products."

Blair continues, "Some treasurers will prefer to engage directly with fintech; others will prefer the perceived safety of known counterparts. To some extent, we also see this playing out in the acquisition of fintechs by treasury management system (TMS) providers."

There are other factors at play, notes Blair. Would corporate treasurers ever be able to manage standalone services, in the same way as individuals do with their financial services? "The proximity of the fintech offering to banking or core TMS also affects the desirability of curation by established players. Thus we see wide acceptance of trading services and cash flow forecasting fintechs as stand-alone solutions. Bank connectivity is also starting to be seen as a viable stand-alone service on the back of increasing standardisation. Supply chain finance (SCF), which used to be a bank service, is increasingly disrupted by fintechs," says Blair.

Judging on the state of play from Citi's Treasury Diagnostic Report from September 2021, however, it seems that many companies still need to focus on the treasury fundamentals. Citi found that 64% of companies in the survey reported that their TMS was either not integrated or only partially integrated with their ERP systems. And 79% reported that they do not have a full integrated TMS/ERP platform with their banks.

Given the complexity of the treasurers' needs, an effective banking relationship is essential. In the consumer banking world, banks have started to be disintermediated, with the rise of peer-to-peer lending, for example, and payment options that don't run on the bank rails. Could transaction banks be ultimately disintermediated? A number of transaction bankers told Treasury Today that corporates will always need transaction banks – they wouldn't be able to do it themselves like in personal finance – because they need the clout of a bank's balance sheet, and banks are regulated institutions, which ultimately keeps their money safe.

Blair comments, "As long as banks are protected by governments, they will be around for a long time, but they will morph to adapt to changing circumstances. For example, the advent of central bank digital currencies (CBDCs) may result in less need for basic account holding services, in which case they will focus on investment and market services, and possibly cash management if that does not get taken over by specialised fintech service providers."

"In a world of CBDCs, it is definitely possible that treasurers will construct viable operations solutions from clusters of fintech services, without the need for any banks at all. In the advent of CBDCs, and if that means the end of fractional reserve banking, banks will have to become much more lean to compete with fintechs – this will be hard for them if their regulatory environment lags market developments," adds Blair.

For now, however, the most viable route for fintechs is to collaborate with banks. Many treasurers that Treasury Today spoke to still prefer to have their bank filter the fintech solutions out there on their behalf.

For the fintechs that try to beat the banks at their own game, that could be more challenging, says McKinsey's Chaudhuri. "It is unclear how long that approach would be sustainable," he says. Chaudhuri argues that the best prospects for fintechs are not as standalone solutions. "The sensible approach is for them to partner with banks," he says. He argues that banks already have the client relationships and they are well positioned to offer an integrated one-stop solution.

> Banks are grappling with their strategy, especially as corporate expectations are going up.
>
> Reet Chaudhuri, Co-Lead, Asia Payments, McKinsey

This is an approach that Capital One has taken. Hoye explains how the bank has introduced its clients to fintech solutions where there is a true benefit to the client. "We like to build it if we feel it is in our wheelhouse, but if there's a fintech company fulfilling a niche client need, we'll often partner to offer that to our clients," Hoye says.

In one example, explains Hoye, the bank introduced its healthcare client to a fintech company to help with the area of patient refunds, something that the industry has typically struggled with. While it could be viewed as them giving away business to a potential competitor, Hoye doesn't see it like that; they are providing a solution that is best for the customer.

In considering the trajectory of fintech innovation and the comparison between retail banking and transaction banking, Capital One actually itself is an interesting case study. Starting its life as a monoline credit card issuer – and nipping at the heels of the large incumbent banks – the company became a full-fledged bank with competitive offerings in the retail banking market. From there it moved into banking for businesses and nowadays offers a range of treasury solutions for small business and mid-market customers in the United States.

In the retail banking space, there have been numerous players that started out as fintech startups and then moved into full-service banking, with a full banking licence. This path means that they can evolve and grow organically without partnering with a bank.

When asked if it is possible for corporate treasury fintechs to be successful without collaborating with banks, Blair at Acarate Consulting says, "Absolutely yes!" He continues, "We are already seeing success for many treasury fintechs in areas not too close to banking and core TMS such as trading, cash flow forecasting, SCF, and bank connectivity. The great thing about the fintech ecosystem is that participants are hungry to try new things and willing to fail, and then pivot as dictated by market needs. Many fintechs will fail, some will end up curated or acquired, and others will thrive on their own. Cautious treasurers will probably have the option of playing safe, but new ways of working will continually evolve and find niches amongst more adventurous and ambitious treasurers from which to grow," says Blair.

In this environment, banks need to decide what role they will play. "Banks are grappling with their strategy, especially as corporate expectations are going up. Banks have to think about how they bring multiple fintechs under their umbrella and package them for their clients," says Chaudhuri at McKinsey.

For those banks that successfully do this, and work out their role in the face of the fintech challenge, they will probably get to keep – and eat – their lunch. ■

Reuse, repair, repurpose and share: the treasury benefits of the circular economy

Companies will struggle to meet their net zero targets unless they adopt a circular approach and reuse, repair and repurpose the components in their supply chains. Elsewhere, new circular models around leasing and subscription could transform sectors from health to fashion.

Industries from food to fashion, electronics and transport, are experimenting with ways to replace the linear take-make-dispose economy into one based on the principles of reuse, repair, repurpose and share. Like brewing giant Anheuser-Busch InBev, turning the barley by-product or spent grain in its brewing processes into a key ingredient for pasta, baked goods and snacks. Car maker Renault now offers battery leasing arrangements for electric vehicles; machinery giant Caterpillar's Cat Reman programme reduces owning and operating costs by providing same-as-new quality components at a fraction of the cost of a new part, while in Brazil, an initiative by HP is leading to the first circular economy initiative in the Brazilian electronics sector.

In discussions on how best to tackle climate change and ESG integration, the circular economy is often overlooked – or even wrongly viewed as a fancy term for recycling. But treasury teams are increasingly mindful of its potential to offer streamlined and predictable cash flows: companies operating a linear model face commodity price spikes and volatility but in the circular economy raw materials are obtained from reprocessing the product and waste is turned form a cost to an additional source of revenue.

Elsewhere, the circular economy offers compelling new growth opportunities and a strategy for reducing Scope 3 emissions, without which companies will never fulfil their net zero pledges. According to research from the Ellen MacArthur Foundation in "Financing the Circular Economy" if a circular approach were adopted in just five sectors (steel, aluminium, cement, plastic and food), annual GHG emissions would fall by 9.3 billion tonnes of CO_2e in 2050, equivalent to the reduction that could be achieved by eliminating all transport emissions globally. As global trends around digitalisation, resource scarcity and supply chain upheaval gather pace, treasury teams are increasingly mindful of the circular economy's impact on cash flows and the future business environment.

Green issuance

The amount of money raised in the linear economy dwarfs that raised to fund corporate circular endeavour, but investors and banks are dipping a toe. The annual issuance of corporate bonds linked to the circular economy increased five-fold between December 2019 and December 2021, with at least 40 bonds issued in the last three years by companies including Alphabet, BASF, Daiken Corporation, Henkel and PepsiCo. PepsiCo's US$1bn green bond will fund key initiatives including reducing its use of virgin plastics and Henkel's US$70m plastic waste reduction bond has gone to finance projects which contribute to its 100% reusable or recyclable target by 2025. "Plastic is not the enemy," says Thorsten Leopold, Director Global Packaging Innovation, Laundry & Home Care at Henkel.

Analysis by Bocconi University in Milan links investor appetite for circular economy assets to the circular economy's direct benefit on corporate health. The University's analysis of over 200 listed European companies across 14 industries found that circular economy benefits like business model diversification, decoupling economic growth from resource use, better anticipation of stricter regulation and changing customer preferences make for compelling investor stories. The more circular a company is, the lower its risk of defaulting on debt, and the higher the risk-adjusted returns of its stock, says Carlo Messina, CEO, Intesa Sanpaolo, one of Europe's largest banking groups which has pursued circular economy strategies as a value creation opportunity for several years, including through its partnership with Bocconi University, and also partnered with the Ellen MacArthur Foundation in its report. "The bank has an interest in evaluating and selecting the most circular companies because there is an awareness of the fact that they are more resilient in the long term."

Intesa Sanpaolo (where a €5bn credit facility supports companies adopting circular business models) is one of a growing cohort including ABN Amro, ING and Rabobank, all overseeing dedicated circular lending programmes. The China Development Bank has helped finance the Qaidam Circular Economy Pilot Zone, which includes CNY400bn (US$56bn) for the construction of six industrial bases. Circular economy investment also ties with investors integrating the SDGs, particularly SDG 12 – sustainable consumption and production.

Scope 3

The need to meet net zero targets is also pushing companies towards circular economy principles. Reducing Scope 3 emissions, the carbon footprint of the components in a company's product and of those products once in use, is

typically the biggest part of a corporate's carbon footprint and the hardest to unravel and measure. It is also integral to achieving net zero. For example, consultants McKinsey estimate that unless there is further action to improve sustainability in manufacturing, 60% of auto industry emissions will come from the materials used in production by 2040. Roughly half the cost of a vehicle is spent on materials that will not be recycled, according to calculations by the Circular Cars Initiative, a grouping of businesses set up by the World Economic Forum to increase the use of renewable materials.

Recent research from the University of Exeter, in partnership with Dutch medical equipment group Philips, found that the NHS will not meet its net zero target unless it incorporates circular economy principles which involve maintaining and extending the life of medical equipment rather than the current approach of using large volumes of single use products and disposing of machines and devices prematurely. "NHS leaders have outlined their commitments to making health services more sustainable, but the pace of change must swiftly accelerate. Our research has outlined that meeting the NHS's ambitious net zero targets is only possible with the adoption of circular economy practices," said co-author Markus Zils, Professor for Circular Economy and Management Science at the University of Exeter.

Leasing and subscription

Emerging demand for leasing and subscription has put companies like Philips at the vanguard of new circular economy models: rather than making and supplying valuable new medical products, Philips is refurbishing and leasing, aiming to generate 25% of its revenue from circular products, services and solutions by 2025 and where circular solutions accounted for 13% of 2019 revenues. Describing the recent leasing of an MRI scanner to a hospital, Robert Metzke, Global Head of Sustainability at Philips Digital explains: "The product has been refurbished, it is a pre-owned system that has been thoroughly upgraded and quality-tested and we have now leased it to the healthcare provider, who can access the solution's potentially life-saving functionality without having to make the capital expenditure needed to own the product." Moreover, modern software means Philips can service the scanner remotely; the company will take it back when needed, refurbish it and lease it again. Similar things are happening in fashion where the clothing resale sector is expected to be bigger than fast fashion by 2029 and data provider Statista estimates the global fashion rental market will reach revenues of US$7bn by 2025. Ralph Lauren is leading the way offering fashionistas the ability to rent the 'Lauren Look' if they sign up to a subscription service starting at US$125 a month.

Challenges

Circular models won't work for every company. The financial viability of new business models based on leasing and subscription compared to traditional manufacturing varies and requires key logistic support. "Treasury will need to support setting up take-back schemes that require logistics to bring products back into the system for repair and repurpose," explains Patrick Schröder, Senior Research Fellow, Environment and Society Programme at Chatham House. "The sharing economy has different revenue schemes and treasury will have to think this through."

And companies like brewer Anheuser-Busch InBev making new products from by-products and upcycling low value ingredients can only do so if they are commercially viable. It's also essential that circular products are made available to everyone – rather than a sustainable choice for the well off. One area this could work includes repurposing white goods, suggests Susan Evans, Interim Head of Resource Policy at the Green Alliance. "Many white goods get thrown out although they are perfectly functioning. They could go to support people in furniture poverty."

The circular economy will only take off with enabling conditions like legislative or tax incentives that encourage the use of re-used, refurbished or recycled products and materials. "Customers need to be incentivised and facilitated to return products through deposit and buy-back schemes, and success requires adequate collection and processing networks," says Philips' Metzke.

It is possible, witnessed in producer responsibility regulation in the auto sector that makes manufacturers and importers responsible for taking back cars at the end of their life, leading to a high level of recycling and recovery. "Cars are expensive, so it has been easier to introduce this circular model," notes Evans. "In the past, the economic incentives were right to encourage repair. We need to shift economic incentives to scale up circular solutions."

Regulation is also growing. Examples include national roadmaps and circular economy legislation in Chile, China, Finland, France and the Netherlands. In 2019, the European Commission presented the European Green Deal, of which the circular economy is a key pillar, and in early 2020 it published the Circular Economy Action Plan, which includes a detailed set of measures to be implemented over the next five years. In 2018, China and the European Commission signed a memorandum of understanding on circular economy collaboration.

The circular economy also requires more transparent and consistent data on circularity performance including dedicated circularity measurement tools that integrate circularity metrics into reporting and disclosure frameworks. A recent study of 7,000 business leaders by software firm SAP found that 26% of companies measure sustainability using in-house metrics, while only 12% adhered to globally proposed measures.

Perhaps the hardest part will be convincing customers to change their purchasing habits – it's more convenient to buy a new model and the linear economy has been around for many decades. Appealing to altruism only goes so far: companies need to create great products at a lower price than ownership. In its report, the Ellen MacArthur Foundation concludes progress now depends on banks scaling circular economy financial products and services and building on existing proofs of concept.

Treasury can begin by collecting all non-financial data around resource efficiency and waste, beyond what they are currently doing around net zero and carbon, digging down into their supply chain. Treasury can also play a role allocating funds to the long-term investment the circular economy requires, balancing short-term cash needs against the strategic investment needed to create resilience. "Investment now is best way to prevent losses in the future," concludes Chatham House's Schröder. ■

The payments and beneficial ownership quagmire of Russian sanctions

Sanctions are an extension of government foreign policy and a breach can unleash profound financial and reputational implications. Treasury's role in ensuring compliance of the unprecedented and sweeping sanctions in response to Russia's invasion of Ukraine is both vital and complex.

Ever since western economies imposed sweeping and unprecedented sanctions on Russia's oligarchs, central bank and SOEs, international banks have scrambled to manage their Russian exposure, particularly in their investment banking operations, alert to suspect shell companies and third parties, or sanctioned entities evading SWIFT to send and receive funds via crypto transactions. Meanwhile, corporates have rushed to ascertain beneficial ownership in their supply chains and ensure no payments to or from sanctioned entities pass through treasury, juggling the challenge of ensuring the company fulfils its contractual obligations while remaining inside covenants as the rulebook for doing business in Russia is changed for the foreseeable future.

Sanctions have been around for years, and companies are well prepared with controls and screening processes. But even corporates with the most robust sanctions programmes and limited direct exposure to sanctioned entities were caught unaware by the scale and speed of their imposition in February 2022. "We have a well-defined process that involves sanctions checks on all our customers, vendors and banks. We were able to ease the latest Russian sanctions into this existing compliance structure however the breadth and velocity in which they were implemented was challenging," says Dubai-based Toby Shore, Senior Director and Group Treasurer at Emirates Global Aluminium, one of the world's biggest aluminium producers where minimal Russian exposure in dollar terms rests in a handful of relationships. Despite the UAE not imposing any sanctions on Russia, the risk of a breach of sanctions would be far reaching, especially regarding financial covenants in syndicated financing documents with US-based lenders, including multilateral agencies. "A breach of sanctions could cause large reputational damage to EGA as well as possible fines and the financing being called in," says Shore.

Payments

For many companies with Russian exposure, one of the biggest treasury challenges has manifest in paid for goods not being delivered bringing a new level of risk into pre-payment structures. Although Russian entities are still legally able to export their goods, transport is scarce. Witness how container shipping lines have suspended new bookings to Russia for fear of carrying sanctioned cargo while Europe's ports have clogged up because of customs checks to comply with sanctions. Elsewhere grain, iron ore and oil exports from the Black Sea are stuck after the region was classified as a high-risk war zone by the Joint War Committee, an advisory body that guides insurers.

"Pre-paying for goods and services with entities in sanctioned countries during times of geopolitical tension is a first order of risk," says payments expert Natasha de Terán, former Head of Corporate Affairs at SWIFT, a member of the Bank of England's CBDC Engagement Forum and the author of "The Pay Off: How changing the way we pay changes everything". She notes that the due diligence cost incurred by banks seeking to execute legitimate Russian payments on behalf of clients is likely to have risen to such an extent that the fees they can charge for doing so will have become punitive for their clients, especially when the cost of currency volatility on the conversion is factored in. And this is on the assumption that corporates can find banks willing to transact on their behalf in the first place. "Banks can prevent you doing what could be legitimate because the legal and reputational risk they themselves face is so significant; the uncertainty and complexity of existing sanctions, coupled with the likelihood of sanctions escalation means they will often over-comply with sanctions. Banks may often refuse to deal with entities because they might be sanctioned in the future, or because they are on another country's sanctions list," she explains.

Beneficial ownership

The impact of sanctions on corporate supply chains holds another layer of even more complex and onerous processes. Companies are scrambling to ascertain the true ownership structures of their Russian customers, suppliers, partners, service providers or contractors in what can amount to thousands of relationships lest they are owned by a sanctioned entity. Until now, many corporates selling and buying uncontroversial Russian products had no obligation to know the ownership structures of their customers in this kind of depth, says Andrew Henderson, Head of Due Diligence Proposition at LSEG and an expert on third-party risk. "They have been under no obligation to know the ownership structure behind their customer but in a significant change, they now need to know ultimate ownership."

The process is particularly challenging when it comes to ascertaining the ownership of companies in the supply chain. “It can be very difficult to see the whole ownership chain of a business,” explains Heather Robinson, Head of FS Operations at KonexoUK, a division of Eversheds Sutherland who reports an upcoming dramatic increase in companies’ due diligence workload. “Before, due diligence typically involved being able to identify beneficial owners of anything more than 20% of a business, dependent on risk posed to the business and the risk appetite of the firm. Now, our clients say they need to know the ownership structure down who owns 1% of the business.”

Technology

Getting the due diligence and onboarding right has pushed technology centre stage. Corporates can no longer rely solely on banks’ screening technology to manage their sanctions risk and need to integrate sanctions screening tools into their own treasury management system (TMS) or use third-party screening programmes to flag any suspicious transactions. Technology is a vital tool, agrees LSEG’s Henderson who notes that once companies have identified beneficial ownership, they can apply sanction screens in a workflow process. “For most of our clients, sanctions are just one of the risks in their supply chain or distribution channel but the rate of change in sanctions has increased their focus,” says LSEG’s Henderson.

That said, many companies are relying on manual processes to check the sanctions list (which in the early weeks of the war increased by over 300 names on one day) with their customer base. Sifting through a paper trail written in Russian to ascertain beneficial ownership is daunting enough, especially combined with different countries having different sanctions. “It’s not a one size fits all,” says Robinson, “Companies are really feeling pressure in terms of screening and the volume of changes because of the reputational pressure of being caught out.” Next, companies need to put monitoring processes in place and stay across any changes to the list in a case management process that incorporates legal advice. “If these processes are weak, companies will find themselves with a book of customers they don’t want,” warns Robinson.

Fallout

Sweeping sanctions against Russia have also had important and wide-reaching ripple effects. EGA – with no direct exposure to sanctioned companies or people – has still felt the fallout, particularly manifest in restricted access to SWIFT. The company had contractual obligations to honour payments to its Russian suppliers incurred before the announcement of the sanctions, but the avenue to remit funds dramatically narrowed and became more complex, explains Shore. “In another twist, the compulsory conversion of FX into roubles by Russia’s central bank caused further challenges in meeting our contractual commitments,” he adds.

Western companies left unable to pay unsanctioned Russian customers and clients because banks compliance teams won’t authorise or process payments or offer trade finance is now commonplace, agrees LSEG’s Henderson. “If a company can’t pay clients and customers in the normal way, they aren’t going to be doing much business and it’s causing another challenge. Many companies are having to stop doing business with Russian entities whether they are sanctioned or not.” And it’s just as much of a factor for corporates in countries that haven’t imposed sanctions on Russia because failure to comply could trip secondary sanctions. That said, experts also report a merry go round of onboarding and offboarding whereby corporates offboard a client because they are outside their risk appetite, only for them to onboard with others.

The future

Small companies conducting short-term, risk-free transactions will continue – or return – to doing business with unsanctioned Russian entities. However, once they’ve left, large companies and banks will be very slow to return to Russia because of the cost and reputational risk. When sanctions were lifted against Iran in 2016, big business proved very reluctant to return. “Sanctions are easier to put on than take off,” says de Terán.

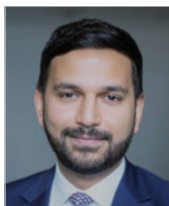
Changes to today’s FX processes could be another long-term consequence. Currencies have been weaponised by the war, illustrated in western economies freezing Russia’s foreign currency holdings in overseas central banks. One argument, increasingly heard, suggests that countries like India, Brazil and China won’t want to build large allocations to dollars overseas that could be confiscated if they incur the wrath of the US, challenging the idea that, as the idiom goes, dollars are as safe as houses. It could lead to corporates in these countries having more currency pools abroad or extending out their hedging programmes. When it comes to strategic imports, countries might even request payment in their local currency, or go through other currencies than the dollar. “From a treasurer’s point of view, the world starts to look a bit more complicated,” says de Terán. In contrast, although EGA’s Shore agrees that longer-term there may be greater calls from some quarters to move away from the US dollar as the world’s global currency, it is unlikely any time in the immediate future. “The lack of a viable alternative to the US dollar will maintain its primacy in global trade,” he says.

Could crypto begin to fill the gap in another long-term consequence? At the moment, treasury teams need to be equally (if not even more) wary of crypto transactions and particularly mindful of customers offering to pay or receive payment with crypto because they can’t pay via banks. “While crypto is not bad by itself, it isn’t necessarily an alternative. Even presuming you are legally allowed to buy the goods in question and that the seller itself is not subject to any sanctions, your bank may not be willing to bank the funds once you receive them, so you will be left holding crypto you can’t necessarily use and left carrying the ‘currency’ risk.” Indeed, she believes that cryptocurrencies are rarely used in a meaningful way for payments except between crypto currencies themselves – so, for example, a crypto trader might sell bitcoin and buy a stablecoin, says Tether, before reinvesting – much as you might sell out stocks and hold cash.

In one positive aside, experts conclude that compliance teams will be given a degree of slack by the regulator. “There isn’t zero tolerance to getting it wrong,” explains Robinson. “But there is a very low tolerance to getting it wrong.” If a company breaches sanction is a minor way, making one payment to a sanctioned entity, a declaration could suffice; any more breeches will bring an investigation, scrutiny and expose control weaknesses. “The penalty for getting it wrong can be huge but it is a spectrum; corporates should act quickly and put their controls in place,” concludes Robinson. ■

Payments/ISO 20022/SWIFT

What does ISO 20022 mean for the payments industry and how should treasury prepare?



Nasir Ahmed
ISO 20022 Programme Lead
SWIFT

Cross-border payments can be constrained by unstructured, incomplete and inconsistent data. This low-quality data is subject to different interpretations and can require manual intervention and repairs before processing. To overcome this challenge, a modern data standard, ISO 20022, was created. As an open international data standard, it brings significant benefits in the form of increased automation, faster processing, and improved mitigation of financial crime risk – all critical components in the cross-border payments process.

Already used by payment systems in over 70 countries, ISO 20022 will be the de facto standard for high-value payment systems of all reserve currencies by 2025, supporting 80% of global volumes and 87% of the value of transactions worldwide. In addition, starting from November 2022, the SWIFT community will start adopting ISO 20022 for interbank cross-border payments and cash reporting, with a coexistence period with MT messages until November 2025.

While many corporates have been using ISO 20022 for a considerable period now, the upcoming transition will bring further benefits for not only corporates but everyone within the payments industry. This wider market adoption means that corporates will be able to embrace the benefits of true end-to-end integrity of a financial transaction by ensuring that data flows seamlessly without truncation or alteration as the transaction progresses through its lifecycle. Corporates will be able to make real-time, data-driven treasury decisions and focus on their core business and opportunities for innovation. Richer quality data also means that corporates will have access to deeper analytics for more accurate forecasting, which will support more sustainable business growth. Ultimately, it will drive the next generation of business innovation.

As many in the banking community (banks, financial institutions and their vendors) will move to full ISO 20022 capacity in the next three years, there's a clear need for corporates to adhere to these new standards as well. Such a major transition within the payments industry will create a strong demand from banks to their corporates to be fully ISO 20022-compliant to ensure interoperability and data integrity all along the payments and reporting chains.

Global interoperability means harmonising ISO 20022 market practices worldwide. In preparation for this new phase of cross-border payments, corporates need to take the necessary steps along with their ERP, TMS and related system providers to upgrade to ISO 20022. To do so, these systems need to be configured to support rich and structured data. This will ensure that all data meets compliance and due diligence standards.

Corporates should also consider early adoption of ISO 20022 cash reporting and statements to receive higher quality data, ultimately facilitating auto-reconciliation. Supporting new data elements can also assist in achieving seamless data flow. This can include upgrading to the newer pain.001 V9 and consolidating payments and cash reporting using a forwarding agent.

With the expectation for corporates to deliver payments fast, efficiently and securely, ISO 20022 adoption is imperative for a fast and frictionless future for the payments industry.

James Kelly
Group Treasurer
Pearson

Why ISO 20022 could be a game changer

Much of the complexity of treasury transformation derives from bank statement reporting, specifically:

1. Creating rules to successfully import bank balance and transaction reporting (banks typically have different file formats).
2. Ensuring that reconciliations and cash allocation can be automated despite information potentially being truncated.
3. Different file formats per region or per frequency.

This often results in expensive consultants being required to build rules, extensive testing and issues if and when banks make changes to formats.

The best cash allocation software requires time-consuming implementation, but can use AI and attachments to compensate for truncated payment references to achieve well over 90% automated cash allocation. This works best with remittance advices as well as the payment.

This lack of standardisation equally makes interoperability between systems and companies very difficult. As an example, where remittance advices are used – who chooses the format? The beneficiary? If so, the remitter has to use lots of different templates. Or if it's the remitter, then the beneficiary has to be prepared for multiple formats. We are equally seeing this with APIs: with each bank taking their own approach to APIs, it makes working with multiple banks challenging. For corporates, the ISO 20022 standard has

been around for some time, allowing corporates to move to XML file formats and richer data – and this is next on our roadmap, so that we move to richer, more real-time data.

However, what is changing is that cross-border payments are migrating for banks to ISO 20022, meaning that it becomes mainstream and so ERP providers and treasury providers will start to provide capability by default.

This should make a transition from MT940/942 or BAI files to XML much more straightforward. For our part, in order to shift to XML we will need to ensure that our ERP and TMS are both set up for the new file format. As CAMT files can still vary in structure, we may need work to ensure that the systems can read files for each bank, which may vary. This allows access to the world of APIs and real-time treasury, allowing pay by bank solutions to rival card solutions for pace and data.

ISO 20022 files will also make sharing data via blockchain easier, with standard naming conventions meaning that the same fields can be mapped to each other in different systems. Again, the power of this is being seen in some of the early blockchain solutions, particularly in the supply chain finance space, where API calls can be used to trigger payment for goods and services.

The potential of richer data is enormous. Solutions such as virtual accounts exist to address challenges around reconciliation. With XML files with stronger references, they may not be necessary. However, success depends on whether common implementation approaches are adopted – standard bank file formats, other users making use of the richer reference fields, etc. My suspicion is that a shift to XML will yield benefits – but until adoption is widespread, and tools like blockchain make a common approach more or less mandatory, it may be some time before we see the full potential.

Rijuta Jain

VP, Product Management,
Payments
FIS

Treasury departments of large global corporates are often dealing with complex payments processes and environments, including multiple banks. Cash management and funding are often managed locally in the various countries, where multiple banking partners are involved. By using a combination of different bank communications channels like SWIFT, host-to-host communications in shared service centres or web-based banking systems in subsidiaries, it is difficult for corporates to integrate these channels effectively within their TMS and ERP systems.

With disparate systems and processes, treasurers lack the visibility and control across their payments. Their decision-making is impaired if they can't see what payments are leaving the organisation. Without the proper automation and workflow in place, companies are at risk of errors and the increasing risk of fraud.

New technology, which connects corporates with their financial partners, particularly with banks, is evolving fast. Cloud-based solutions integrate services so that corporate treasurers can gain access to a wide range of additional services through one single access point. Increased standardisation for exchanging financial messages between counterparties will allow easier integration of systems and processes, thanks to ISO 20022.

Using the more structured and richer data that ISO 20022 provides allows not only better straight through payment processing, but also helps corporate treasurers further automate their reconciliation processes, and therefore increase payments speed and reduce costs. By implementing these ISO 20022 messages, more information can be provided to compliance departments when performing sanction screening or transaction monitoring, and may also enhance fraud prevention and detection. This will lead to a more seamless client experience as those payments are embedded in the processes that they support.

There are other possible implications of ISO 20022, however. One is cost. If you continue to send payments using MT formats, the bank will need to convert the messages to ISO 20022 – which is likely to result in higher fees. Another consideration is that banks are continuing to work on upgrading to newer versions of ISO 20022. As a result, organisations that don't have a payment hub will have to upgrade their back-end systems and carry out development in their ERP systems, which is likely to be an expensive undertaking.

ISO 20022 is a game changer and signifies an opportunity for banks and corporates to improve operational efficiency and reassess existing business models. By taking out all the effort that today is spent on message translations, conversions, manual reconciliation etc, allows every actor in this payment chain to focus on value added activities, on data driven services, on better liquidity forecasts and better risk models.

The good news is that the migration is not mandated for corporates. Older messaging formats will still be supported. But companies that don't migrate will not be able to harness the opportunities brought by richer data. Companies that already have a payment hub between their ERP/TMS systems and bank communication channels, that is fully compliant with ISO 20022, will be able to benefit from the changes. However, companies that don't have a payment hub will need to start a dialogue with their banking partners and ERP/TMS providers. Preparation for ISO 20022 should start now, whether a large corporate is looking to adopt to ISO 20022 end-to-end, or a smaller company simply wants to provide the necessary party and remittance information to its banks. ■

Next question:

"How is the competition for talent affecting treasury and wider corporate health, and what are the best strategies for recruiting and retaining talent?"

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

Rough seas for financial markets

Financial markets are faced with many uncertainties because of the Ukraine war, geopolitical tensions, higher inflation and deteriorating growth prospects. Here are a few possible scenarios.

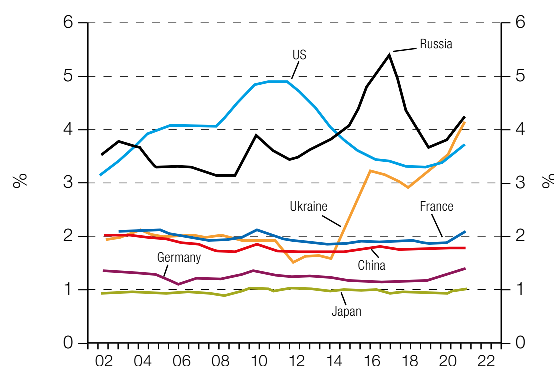
Russia's invasion of Ukraine has not gone to plan and the country is also labouring under unprecedented economic sanctions. Western governments continue to supply the Ukrainian army with weapons, making things progressively difficult for the Russian army – add to that the fact that the Ukrainians have far more motivation to fight. Hence Russia will only be able to seize a limited part of Ukraine. At the same time, the Ukrainian army will ultimately prove too small to defeat the Russian army.

We draw two conclusions from this:

The war in Ukraine is likely to become a protracted conflict – perhaps occasionally interrupted by a temporary ceasefire – with Moscow attacks targeting civilian casualties as has very often happened in Russia's recent wars.

The West will lend increasing support to Ukraine, while Russian propaganda against the West will intensify accordingly. This could lead to Moscow taking an increasingly aggressive military stance against the West with the view that the more the West is provoked in this way, the better. Indeed, any military action by the West will be framed as an attack on Russia. Moscow will increasingly need this, because developments in the Ukraine war remain disappointing for Russia so far.

Chart 1: Military expenditure as a share of GDP



Source: Refinitiv Datastream/ECR Research.
Stockholm International Peace Research Institute (SIPRI).

Expensive bloc formation

It remains to be seen what economic consequences this will have:

The war in Ukraine will yield too few victories for the Russian rulers meaning that the democratic West will therefore be increasingly portrayed as a major enemy. Consequently, defence spending in the West will have to be ramped up considerably for many years to come.

It would be irresponsible if the West remained highly dependent on imports of Russian commodities. Alternative sources will have to be tapped for this. This will also cost vast amounts of money.

There is a possibility that China will head in the same direction as Russia, which could reverse the economic intertwining between China and the West to a certain extent as more Western companies will opt to bring production closer to home – rather than manufacture in China. The result is that the world will be increasingly divided into two blocs – one around the US and one around China, with limited trade between the two blocs. In this case, the West will lose many of its inexpensive production facilities, resulting in more expensive imports and products.

The fight against climate change is another major factor. Governments need to play a key role, costing large amounts of money.

In summary, for the time being, we expect a climate of massive violence stemming from the war, increasingly far-reaching sanctions from the West and persistently high commodity prices (or at least commodity prices that will be considerably higher than they would otherwise have been – they could fall back in the event of declining economic growth). At the same time, we expect persistently high public deficits.

A shift in monetary policy

This brings us to the next point. As long as inflation stayed low, central banks were able to buy vast amounts of bonds with surplus money created for this purpose. However, inflation has since risen to high levels, which is why this can no longer be

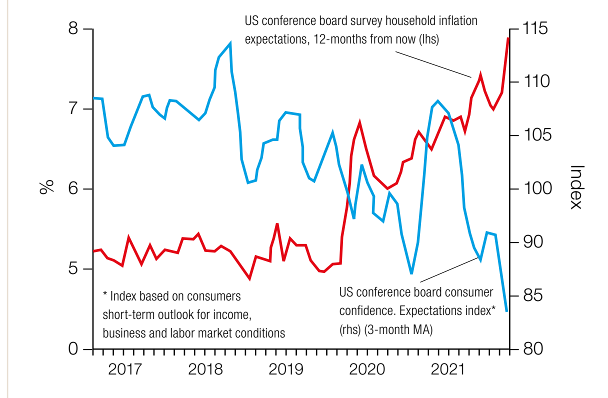
ecr research

done without losing the confidence of bond investors. Central banks will therefore have to terminate this policy.

This policy has been pursued for many years, and this has resulted in enormous amounts of surplus money. This money has stayed with the banks or assets have been bought with it (shares, bonds, property to name a few). This money could still end up in the real economy, certainly if inflation and public deficits stay high. In order to retain the confidence of the bond market, it will be necessary to remove a large proportion of this surplus money from the system – by having the central bank sell the previously purchased bonds and/or by not replacing expiring bonds with new ones.

In short, the supply/demand ratio for bonds and money creation by central banks will change drastically. Rather than buying bonds, central banks will sell them and rather than creating money, they will extract money from the system. This will result in additional upward pressure on interest rates – especially on long-term interest rates if public deficits stay high.

Chart 2: US consumer confidence regarding the near future has dropped sharply as inflation worries mount



Source: Refinitiv Datastream/ECR Research

A reservoir of negative forces

Recent US economic data has been fairly strong. This is probably due to large-scale fiscal and monetary stimulus schemes that were implemented in response to the corona crisis. However, forces that have a negative impact on economic growth are becoming stronger (incidentally, Europe has had weaker data for some time):

Elsewhere expect a loss of consumer purchasing power and a decline in confidence in the future due to the Ukraine war and high inflation.

The Fed has to hit the monetary brakes. The American political situation is increasingly moving towards a fiscal policy where deficits will not be raised any time soon. This will therefore not support economic growth to any great extent. Most inventories are back to normal, and more stockpiling is unlikely to significantly boost economic growth.

Consumers are unlikely to borrow more in the current uncertain situation. We see more and more stagnation in global trade due to ever-increasing sanctions against Russia and mounting problems for many emerging markets. We fear that all this will culminate in US economic growth falling back to around 1% before long, while economic growth in Europe will be on the brink of recession. In this light, we expect the following:

Long-term interest rates are likely to consolidate before too long (we expect this to be a temporary decline in the context of a long-term uptrend in interest rates). We will see a shift in the expectation that central banks will quickly raise their rates and switch from buying bonds to selling bonds. This will still happen, but to a lesser extent and more gradually than is generally expected at this point. Commodity prices will consolidate, and they could even decline after a while. Share prices will come under more downward pressure.

We still expect central banks to intervene as soon as the economy threatens to lapse into a recession. Once inflation clearly falls back as a result of this, central banks will hit the monetary gas again. Public deficits might also be raised in this case hitting the fight against inflation. ■

INTERESTED IN OTHER MARKETS?

Go to www.ecrresearch.com and request access to 18 different reports & services. Clear views and concrete market predictions, based on the world's leading research.

MAARTEN SPEK

Senior Financial Markets Analyst
+31 (0)30 23208000
m.spek@ecrresearch.com

Independent research on asset allocation, global financial markets, politics and FX & interest rates

ecr research

treasurytoday.com