March/April 2022

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Treasurers prepare for e-CNY

China's central bank digital currency – the e-CNY – is gathering pace and treasurers who ignore it may live to regret it.

The Corporate View

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Director, Group Treasury
Trip.com Group

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Springing into step

As we bring you our March/April edition of the magazine we explore the essential issues for the APAC treasurer against a backdrop of global disruption and unsettling political developments.

In times of challenge and uncertainty it is never more important to come together as a community to share best practice and to learn from one another. So, we are delighted to bring you our features for this edition as well as updates on our programme of activities for 2022. The Adam Smith Awards Asia 2022 will open for nominations on June 6th and we are planning a physical/virtual hybrid celebration to take place at the end of the year in Singapore. We are also preparing for a physical return for our Women in Treasury APAC Forum and associated activities at the end of the year, as well as continuing to deliver hybrid/virtual events to ensure wherever our community members are located that they can access our resources.

There is no one size fits all approach for the region and we explore the specificities of an exciting country with bold plans, which is Japan. Long known as being very paper based, with practices like the hanko 'chop' or seal, the country has been forced to digitise by the ongoing pandemic and this has brought unforeseen changes and altered the future vision of the island country. We look at the rise of digital currencies, a trend in all industries and a topic of conversation in many restaurants, cafes and bars across the world, what do the peaks and troughs associated with these new types of currencies mean for corporate treasurers and how can they fit into your plans?

In recent years, Singapore has become synonymous with innovation and is pioneering innovative approaches to, well, just about most things. What does this mean for treasury based there, as the drive for collaboration and new ideas extends to all things financial and technological as well as sustainability and more? Elsewhere in this issue, alongside our Corporate View and This Much I Know features, we assess global trends including funding and investing and take a deep dive into sustainable treasury, exploring the role that treasurers play in the variety of activities associated with corporations' efforts in sustainability.

We hope you enjoy this edition and, as ever, we exist to serve our readership and our corporate community. Therefore, if you have any feedback, ideas or topics you would like to see us explore, then please don't hesitate to reach out.

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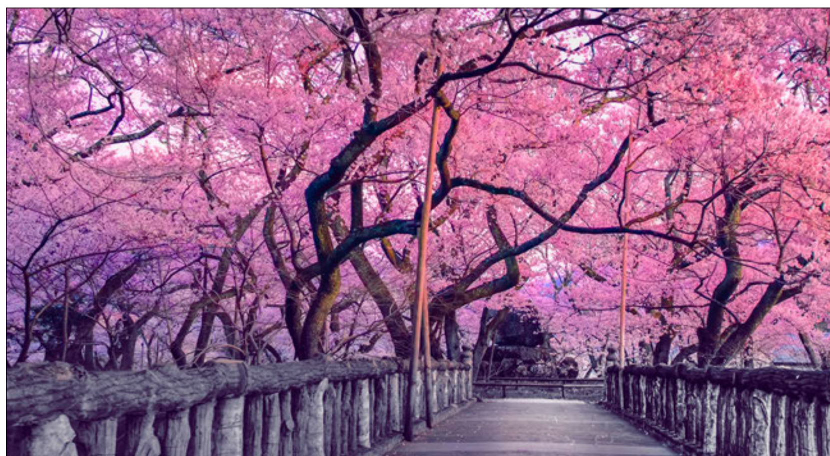

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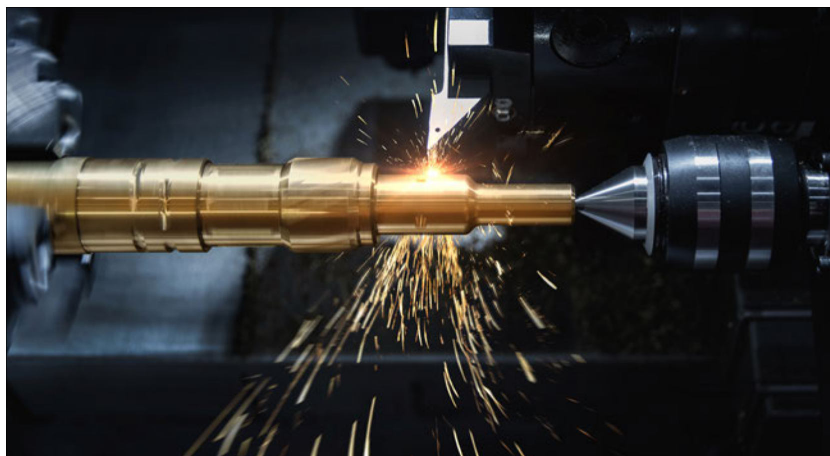

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e-CNY trials push treasurers to prepare

China's central bank digital currency – the e-CNY – is gathering pace with more users trialling it by the day. Although it has been designed for retail payments, treasurers who ignore its adoption and don't prepare themselves for the future of CBDCs may live to regret it.

The recent Beijing 2022 Winter Olympics showcased China's ability to host an international event, and it was also an opportunity to show off its digital currency. Athletes and visitors used the e-CNY at the Olympic venues and the transaction figures point to a promising future for the central bank digital currency (CBDC). Approximately RMB3m (US$316,000) was spent each day at the event, according to reports that quoted Mu Changchun, Director-General of the PBOC's Digital Currency Research Institute.

It could be easy for treasurers to think that because the e-CNY is still being piloted, there is no need to do anything just yet. However, the numbers are already staggering: by some estimates 140 million people have created e-CNY wallets and over 1.5 million merchants are already accepting e-CNY payments. With China's population being so large, even its trialling of the CBDC is significant, and the project is much further ahead than the other major economies trying to get their digital currencies off the ground.

Urszula McCormack, a partner at law firm King & Wood Mallesons (KWM) and specialist in the digital economy and emerging technologies, describes CBDCs as lying on a spectrum. At one end are the broad projects – such as China – where the digital currency seeks to renew the existing currency and potentially even replace cash. At the other end of the spectrum are projects that are very specific in their use case. One example is Australia's Project Atom, which has trialled a wholesale application of a CBDC specifically for syndicated lending. "And then there is everything in between," adds McCormack.

CBDCs are part of a wider story of renovating money, says McCormack. This includes real-time payments, more efficient

cross-border payments and generally reducing friction, cost and time from transactions.

"As custodians of their institution's wallet, treasurers need to know that the whole payments infrastructure is changing all around the world," says McCormack. She uses an analogy to describe how various jurisdictions are approaching CBDCs: "Some are knocking down the house and rebuilding it. Others are adding a new room, while some are just giving the house a lick of paint," says McCormack.

In China, for the companies that haven't already been affected by the e-CNY trial, they need to start making plans. Linghao Bao, Analyst at Trivium China, explains that when it is legal tender, businesses will be obliged to accept it, if their customers want to use it.

"There's time for businesses to get ready. And the central bank will ask big retail companies to test this first," Bao adds. This is already happening and a number of large corporations have been involved in the pilots in various cities, including McDonald's, ride-hailing app DiDi Chuxing, and the e-commerce company JD.com reportedly used e-CNY to pay its employees.

Aziz Parvez, head of Asia Pacific Corporate Treasury Sales, Global Transaction Services, Bank of America, comments that some corporates have been trialling e-CNY for utility and tax payments. And when the project is rolled out further, corporates stand to benefit from the efficiencies the digital currency can bring. "A broader adoption of e-CNY would provide comprehensive benefits to treasurers, given e-CNY is legal tender and a digital version of the fiat currency issued by PBoC [People's Bank of China]," he comments.

Retailers and e-commerce companies are a natural place for the e-CNY to be tested. For consumers, the e-CNY will seem like another payment option – alongside Alipay or WeChat Pay, for example – that is being offered by the retailer at the checkout. It may seem simple for the company to offer this additional option, but there are a number of considerations for treasurers as they understand how this new infrastructure operates behind the scenes. These include how their bank connects to the e-CNY systems, and how the e-CNY is converted into other currencies and held in accounts.

To use the currency, consumers will need to have an e-CNY digital wallet – typically an app on their smartphone – with funds loaded from their regular bank account that have been converted into e-CNY. Banks could offer this as part of their usual mobile banking service, but the e-CNY funds are different from the regular deposit accounts. Technically, e-CNY has the same quality as cash or, in economics parlance, M0 – the money that is in circulation and a liability of the central bank. This is distinct from M1 money that is deposited in bank accounts and is a liability of a commercial bank, and for this reason e-CNY has to be kept separate from regular bank deposits.

It is expected that the e-CNY issuance will occur in layers, with the PBoC – the central bank – at the top, issuing the currency to commercial banks, who will in turn make it available to their customers. Banks will make it available to both individual consumers and also companies. Also, non-bank financial institutions and other providers will be able to offer e-CNY wallets.

Parvez comments on the features of the digital currency and what it means for corporates and their treasurers: "With e-CNY, the only necessary intermediary would be the central bank. e-CNY would provide the benefits of shortened collection periods, because payments could be completed – finality – at the moment e-CNY is delivered as legal tender. It would additionally ease the process of account reconciliation through the end-to-end electronic solution. As such, the implementation would help treasuries achieve cost efficiencies and better cash flows management," says Parvez.

For now, the e-CNY is a retail payment system and will have an impact on all types of corporates, although some more than others. Parvez says "the flows could be higher for corporates dealing in business to consumer, and consumer to business" transactions and the impact of the e-CNY would be greater for those companies.

Parvez comments that there are a number of things that treasurers can do to prepare ahead of the formal rollout of China's CBDC. This includes setting up corporate guidelines to adopt digital wallets to accept e-CNY payments. They can also establish the necessary hardware and software to start accepting e-CNY, for example scanners for reading QR [quick response] codes, and software programs like online e-wallet transfer capabilities.

Also, Parvez continues, the newly-added software needs to be integrated with the company's existing enterprise resource planning and treasury management system to streamline accounts reconciliation. This is especially important when processing anonymous transactions with missing payer information, he adds. Also, e-CNY adoption entails fewer hardware requirements – such as QR code scanners – so treasurers should focus more on software integration to enable online e-wallet transfer capabilities, offline e-CNY payment function and streamlined account reconciliation, says Parvez.

What would happen to the treasurers who don't take any of the steps to prepare, or even ignore CBDCs altogether? KWM's McCormack points out if CBDC use becomes mandatory in a particular market or for a particular type of transaction context – whether by law or contract – treasurers will inevitably need to evolve their own systems and processes, although access will likely still be through their banking and payment providers. When it comes to implementing the systems necessary to handle CBDCs, if they have been slow to react, they may find that they are at the back of the vendor queue, says McCormack.

Another issue, comments McCormack, is the contracts that treasurers have with their banks, for example, are likely to be updated to make sure they are relevant for CBDCs. This can present an opportunity to consider whether new payment or operational mechanisms would better suit their needs.

Could treasurers leave it to their banks to think about this on their behalf? Possibly, but it would be better for them to be ahead of the curve. McCormack says it is important for treasurers to start talking about CBDCs with their banking partners now, and by asking questions they are signalling that they expect their counterparts to have adequate plans and protections in place for handling CBDCs.

There are still quite a few unknowns with the new digital currencies. McCormack says that treasurers will need to

grapple with the uncertainty surrounding the CBDCs for some time. In the case of e-CNY, for example, the specific technical integrations that will be necessary have not been made fully public, nor have the full gamut of onshore and offshore applications, and so what it actually means in practice for businesses and users still remains to be seen.

Treasurers are already used to digital payments, but the difference with this infrastructure – notes a recent Oliver Wyman report – is that this system is sponsored by the Chinese government rather than the private sector.

One of the concerns with the e-CNY and other CBDC projects is that the state will have eyes into corporations and will be able to have visibility of all their transactions. "In the case of e-CNY there is a very careful approach about what data is collected, who can see the data and for what purpose," says McCormack. She explains that data provision is tiered and for low-value transactions there is not much data needed to onboard, whereas for high-value transactions, a lot more information would be needed. "Globally, data privacy and security is always in the top two or three issues that are debated when designing the architecture for CBDCs," McCormack says, adding that the debate focuses on protecting both personal and professional privacy, as well as protecting the data from cyber criminals.

Another feature of CBDCs – with them being issued by central banks – is how they can be liberalised and extended into a cross-border, and offshore system. If the Chinese government liberalises the e-CNY – in a similar way as it has done with the internationalisation of the renminbi – it could accelerate the renminbi's adoption as a global trade currency, according to Oliver Wyman. For now the e-CNY is a retail system, but if its use is extended to cover wholesale payments, and is used by large institutions for cross-border transactions, it could supersede the dominance of the US dollar. If cross-border transactions are in e-CNY, and use the new payment rails, it could bypass the need for SWIFT's messaging and its correspondent banking network. "A new dawn of currency is upon us, and the time to act is now," the Oliver Wyman report states.

The e-CNY project is effectively "super-charging a currency and making it super competitive because of how easy it is to use," explains McCormack. With buyers and suppliers on a Belt and Road project, for example, they could transact via their CBDC wallets. "They can make that payment in a trusted and auditable way – to a degree not available for cash or traditional banking rails. It is an extremely compelling proposition," says McCormack.

The currency could be used by overseas companies for transactions that don't reach China onshore, much in the same way as the offshore renminbi – or CNH – has been used. At the moment it is unknown how far the e-CNY will be internationalised and if it will be available for offshore companies to pay counterparts in China or vice versa.

If, however, the e-CNY is extended to cross-border usage it could provide substantial savings. Oliver Wyman's 'Digital Currency Battleground' report estimates that if the CBDC could be used between China and Singapore there would be costs savings of SG$16bn to SG$24bn, or up to 5% of Singapore's GDP.

With China leading the way in the central bank digital currencies, other markets – and treasurers more generally – need to take note. And a global, interoperable infrastructure for CBDCs is already being considered as other countries explore what the implications of the e-CNY will be. A prototype has already been built for multiple Central Bank Digital Currencies (mCBDCs), which is being developed by the Bank for International Settlements, the Hong Kong Monetary Authority, the Bank of Thailand, the Digital Currency Institute of the PBoC, and the Central Bank of the United Arab Emirates.

The mCBDC platform has so far demonstrated how CBDCs can offer more efficient cross-border payments and settlements for treasurers – and their bankers. They are real-time, cheaper and safer and 24/7. In a trial of the mCBDC platform, international transfers and foreign exchange transactions occurred in seconds – a vast improvement on the several days that treasurers are used to waiting for their cross-border transactions to be completed.

For the e-CNY to be broadly adopted and used, there will be a number of factors at play. Parvez notes that the wide adoption of China's CBDC will depend on the PBoC's coordination with central and commercial banks around the world. Also, another factor that will be crucial to the e-CNY's success will be the new system for cross-border settlement, which will be something similar to the current Cross-Border Inter-Bank Payments System (CIPS) but with the ability to issue digital wallets to global users. And finally, Parvez notes, adoption will depend on the new regulatory framework globally.

Once the e-CNY does start to gain traction, however, it will open up new opportunities for corporates. It will be possible to rethink the way transactions are done, and in a sense the e-CNY is underpinning – or facilitating – China's digital economy. With its clean slate, the e-CNY infrastructure can be built specifically to interact with other cutting-edge technologies, such as the internet of things and artificial intelligence. And, once the e-CNY is in place, it could spur other organisations to innovate with solutions that haven't been possible before.

"For some treasurers it is unnecessary to think about CBDCs right now. For others it may be quite exciting for them or their group entities to be able to programme payments in a certain way and to explore the opportunities relating to the digitisation of money."

This echoes the possibilities that Brett Turner, Founder and CEO of Trovata – a provider of an open banking platform that automates cash management – told **Treasury Today** in a previous interview. He notes the biggest pain for treasurers is still cross-border payments, and CBDCs have the opportunity to do something about it. He notes that with CBDCs, "You can architect modern technology from the ground up and everything else – all this existing technology – becomes obsolete and you get a chance to have a complete reboot of all that," says Turner.

And he urged treasurers to think about getting their systems ready now: "The time is now to start thinking about your technology and systems environment," says Turner. "People need to start being ready," he added.

As the e-CNY trials gather pace, it will become more urgent for treasurers to consider how China's CBDC – and other digital currencies more generally – will impact them and their treasury operations. For those who don't act now, they could lose out. ■

RUSSIA'S POTENTIAL CHINA PIVOT: SWIFT BAN COULD OPEN DOOR TO CIPS; SANCTIONS TRIGGER OIL SALES TO CHINA

Western nations have announced harsh economic sanctions to punish Russia for invading Ukraine, including blocking some banks from the SWIFT international payments system. SWIFT messaging systems are a critical part of international economic activity, and although being cut off won't prevent Russian banks from carrying out cross-border transactions, it will make payments expensive and difficult and will create a reliance on old-fashioned communication tools. It will also crimp Russia's ability to get paid for its oil and gas exports.

But payments experts also warn that ejecting Russia from SWIFT may have a limited impact. Peter Klein, CTO at FinLync, argues that if Europe really intends to disconnect Russian banks from the international and financial system, all global banks need to act in concert. "All banks should block transactions to and from any Russian bank domiciled in any country globally," he says.

Klein points out that SWIFT is just one third-party method used to move data in an electronic format from one bank to another bank – and there are plenty of other third-party alternatives. Moving money from one country to another country doesn't have to require SWIFT or even different banks.

And since Russian banks are domiciled in many countries, Russian banks don't have to depend on a third-party network like SWIFT to help them transfer data within their own organisation to another country. "Financing coming through loans from other countries doesn't mandate the need to go through SWIFT as a third party. As foreign banks are still operating in Russia, financial transactions can take place over Russia's own domestic payment networks," he says.

CIPS

In another concern, kicking Russia out of SWIFT could accelerate efforts by Russia and China to create a rival payment system that does not use the US dollar. Specifically, it could benefit China's own Cross-Border International Payment System, CIPS, and accelerate the development of the country's digital currency, the e-CNY. Several Russian banks are already connected to CIPS.

China launched the CIPS clearing and settlement services system in 2015 to internationalise yuan use, backed by the People's Bank of China. It allows global banks to clear cross-border yuan transactions directly onshore, instead of via clearing banks in offshore yuan locations.

Participant banks span institutions in Japan, Russia and Africa, where banks have received yuan funds via infrastructure projects under Beijing's Belt and Road Initiative. For now, CIPS still largely relies on SWIFT for cross-border financial messaging, but it has the potential to operate independently and have its own direct communication between financial institutions. Elsewhere, Russia launched its own cross-border payment system SPFS in 2014 but it is mainly used by its domestic institutions.

China pivot?

In the face of the recent sanctions, there has also been speculation that Russia could pivot to China to secure its economic survival. The two countries agreed a 'no limits' partnership in early February – on the opening day of the Winter Olympic Games in Beijing – that increased their collaboration against the West. This included, according to news sources, China supporting Russia's position against Ukraine joining NATO [the North Atlantic Treaty Organisation] as well as broader cooperation on issues such as climate change.

China, however, is caught walking a diplomatic tightrope where it needs to balance being Russia's ally without being viewed by the international community as endorsing Russia's military action in Ukraine.

One way that China could help Russia is for it to pivot its energy exports eastwards with liquified natural gas (LNG), for example. "If Europe were to stop buying from Russia, the infrastructure doesn't exist for Russia to pipe (or ship) equivalent amounts of gas to China. However, China could buy more oil," argues Williams. Chinese importers could also look for deals from Russia in other sectors, and its banks could lend to Russian companies. "China would portray this as continuing business as usual," says Williams. ■

This much I know

Sugandha Singhal

Vice President – Head Treasury

How did you arrive at your current role?

I started my career in sales at Bajaj Allianz Life Insurance, which helped me hone my skills in sales and negotiations. Later I had a brief stint in teaching before moving back to corporate life. I joined SRF Limited in 2005 as executive assistant to the CEO, and after a couple of years I gained responsibility for strategic planning and anti-dumping litigations. I then moved to the treasury department, where I am now the group treasurer.

As a group treasurer, I'm responsible for enhancing stakeholder value through competitive funding, working capital innovation, trade finance optimisation, financial risk management, strategic investment, and cost reduction through technological advancements.

How challenging have the last two years been?

Fortunately, our company continued to do very well during the last two years despite the COVID pandemic raging throughout the world. However, it was a stressful and emotional journey on the people front, as the second wave saw the loss of many lives, and the new online world made it difficult to reach out and extend support to those who needed it.

The last two years gave us the opportunity to learn to deal with change. Today, change is the only constant in our lives, and we have now become more nimble and ready to embrace change. As we have taken steps to manage significant disruption, and set up mechanisms to counter various disruptions in trade, forex, liquidity, interest rates etc, we have learned to innovate and take on new and higher-level challenges.

How has the conversation around inclusion and diversity evolved over the last few years?

The conversation around inclusion and diversity has certainly evolved over the last few years. Today people are not only aware of it, but are also expressing views on diversity and inclusion. But the real question is – are these conversations translating to results? What is the actual impact?

I believe there is still a wide gap, but organisations are taking a positive step in this direction. My own organisation has embedded the diversity, equity and inclusion factors into its value system, as well as in its ESG framework. We need more and more organisations to move from treating this as a "check the box" initiative to having this embedded in the organisational culture.

What advice would you give to women wishing to further their career in finance?

First and foremost, don't be afraid to go outside of your comfort zone and find a mentor for inspiration and advice. The second most important thing is networking and being seen a solution provider in the relevant circles. For this one, continuous upgradation of skill and knowledge is of paramount importance. Lastly, revisit your strategies and change course with agility. Don't strive for perfection in one go – instead plan in detail for various scenarios backed by fallback plans for a higher success rate.

What is your motto in life or your greatest inspiration?

My father always encouraged me to challenge the normal using the phrase 'Nulli Secundus' – you are second to none. This motto reminds me to stay strong in testing times. It helps me challenge my own boundaries and rekindle hope and courage.

"My own organisation has embedded the diversity, equity and inclusion factors into its value system, as well as in its ESG framework."

ONLINE

To read all the interviews in this series go to treasurytoday.com/women-in-treasury

Different paths

For Sugandha, flexibility and adapting to change are key to a successful career. Like many other treasury professionals, she did not set out with the goal of working in treasury. "I started my career in sales with Bajaj Allianz Life Insurance Company," she says. "But I didn't enjoy the sales part of the job. I decided to look for something more intellectually satisfying."

After a period teaching statistics and financial management, Sugandha moved to the role of executive assistant to the CEO at SRF Limited, where she gained experience of strategic planning and anti-dumping litigation. She joined their treasury department in July 2012 and became Head of Treasury in 2020.

Sugandha's advice for those looking to advance their careers is to be open and flexible – in other words, to model various scenarios rather than having a single plan based on a linear progression. "I believe the most powerful force today in finance is change," she reflects. "Every day something new comes along. Who would have thought just a few years back that ESG would become such an important aspect of financing today?"

As such, she emphasises the importance of having a backup plan. "Do not be too tightly wedded to your initial ideas," she cautions. "When new situations come along, new choices open around them. You need to be open to those choices. Because technology is continuously disruptive, any fixed strategy will become redundant at some point."

For Sugandha, choosing to have a career in a field like finance is just the beginning of the story. "What exactly in finance is it that you want to do?" she asks. "Do you enjoy accounting? Or data analytics? Or trade product development? Because if you are doing something that you like, then you will do well." Her advice for those who find themselves in positions where they are not happy is likewise clear: "If you don't like something and you feel stuck, you should find out what it is that you do like and move to that."

Making changes

Sugandha's advice for junior professionals who wish to challenge bias and promote diversity is to be aware of the bias in their behaviour. "Whether we realise it or not, our unconscious biases influence our lives in every aspect," she adds. "If one is aware of these biases and how they are affecting our colleagues, one can start to address them."

She believes it is very important for organisations to have a system in place where employees can anonymously report instances of bias. "People can recognise bias – but at times they are either afraid to confront it, or they are unsure of how to do so. Companies need to have a machinery that not only trains people on how to handle such situations but also empower them to call it out immediately," she says. "And that system has to be anonymous."

Sugandha is firmly of the belief that everything in our lives reflects our thoughts, beliefs and emotions, and that the world reflects the vibes that you put out. As such, for women on the path to making their voices heard within their organisation, there is a vital first step. "Before we even think about our voices being heard, we should value ourselves and believe in ourselves," she says. "Women are harsh on themselves. They have high expectations of themselves and tend to believe that when things go wrong, it must be their fault. The first thing that needs to be changed is your mindset. Once you have the positive energy in you, you will see the changes around you."

She cites the example of a female colleague who was unable to speak when someone else raised their voice. Once she identified the root cause, the solution was simple: "When faced with a similar situation again, she asked her colleague to keep their voice low," explains Sugandha. "This helped her to keep calm and speak her mind."

She concludes: "There are no standard solutions, but if you know the reason why you were unable to speak, you will find a solution. Identify what needs to be corrected – does the problem lie with the organisation or with you? Being able to recognise the root cause is very important, because only then can you introspect and resolve. Every situation is unique, every woman is unique and so is the solution." ■

Sugandha Singhal
Vice President – Head Treasury, SRF Limited

SRF Limited is an India-based multi-business chemicals conglomerate engaged in the manufacturing of industrial and specialty intermediate, packaging films, and technical textiles. With a workforce of close to 7,000 employees, SRF has plants in India, Thailand, South Africa and Hungary and exports to more than 75 countries worldwide.

Since joining SRF Limited in 2005, Sugandha has gained a wide experience across strategic planning and treasury. Progressing to her current position in September 2020, she is responsible for the complete treasury function of the group.

Sugandha was the Highly Commended Winner in the Best Working Capital Management Solution category in the Adam Smith Awards Asia 2021. She holds an MBA Finance from the Dayalbagh Educational Institute in Agra, Uttar Pradesh.

Asia's accounting scandals spur audit reform

A string of high-profile corporate failures and frauds in Asia has called into question the role of the auditors and prompted calls for the profession to be reformed. This falls in line with a global trend of audit reform and a need to adapt to the changing requirements of corporates.

Corporate collapses, frauds and accounting scandals in Asia have blighted the reputation of the audit profession in recent years and have even threatened to undermine investor confidence in their reporting. High-quality audits have been described by the International Federation of Accountants (IFAC) as the "backbone of the global financial system" and there has been a movement across the globe to reform how they are done. This could have ramifications for companies in Asia – and the overseas markets where they are listed – and how they do their corporate reporting.

There is a long list of high-profile cases in Asia that have spurred the need for audit reform. The pattern seems to go like this: a high-profile collapse, revelation of accounting lapses, ensuing litigation and promises of reform.

Jim Peterson, a lawyer and specialist in corporate financial information and author of Count Down: The Past, Present and Uncertain Future of the Big Four Accounting Firms, says that public outrage over the performance of auditors is cyclical. "When things are cruising along nobody cares," he says. And then something goes wrong. "Then they look back and say 'where were the auditors?'," Peterson says. "Then the bureaucrats and politicians stir the pot, then it calms down until there's another cycle. These cycles tend to run on a seven to ten year cycle."

There is currently ongoing litigation related to some of the high-profile scandals. In February, for example, a Goldman Sachs banker was on trial in New York related to 1Malaysia Development Berhad (1MDB) – Malaysia's sovereign wealth fund – and the alleged embezzlement of billions of dollars. The question of 'where were the auditors?' has already been asked in a separate US$5.6bn lawsuit the Malaysian government brought against the partners of KPMG Malaysia. In September 2021 this was settled for US$80m.

In China, the public has also been questioning the role of the auditors in the alleged frauds at companies like Kangde Xin Composite Material Group and Kangmei Pharmaceutical. And when the debt-laden property giant Evergrande defaulted on its bonds, questions were asked about accounting irregularities and why auditors gave the company the all-clear when it was so overstretched. There have been other scandals, such as the fraud at Luckin Coffee, which led to it being delisted in the United States. In August 2021, China's State Council vowed to improve the oversight of accounting firms and published detailed rules on supervision.

A few months earlier, in January 2021, there was a similar move in Singapore to increase the scrutiny of listed companies. The regulatory unit of the Singapore Exchange (SGX) introduced additional requirements for auditors following some accounting scandals, such as the collapse of oil trader Hin Leong Trading and fraud at another oil trader Hontop Energy.

The listing of companies on foreign exchanges has highlighted shortcomings in the audit process. For Chinese companies, the financial statements – or working papers – are deemed sensitive data and cannot be removed from China. This has been the source of a long-running spat between the US and China because US regulators and liquidators cannot inspect the audits of Chinese companies that are listed in the United States. This puts the large audit firms in a difficult position, caught between the interests of the two countries. It also undermines investor confidence in the US-listed Chinese companies.

Pressure has been increasing, and, in December 2021, the SEC finalised rules that would implement the Holding Foreign Companies Accountable Act. This was introduced in 2020 – under the Trump administration – to enable the inspection of US-listed Chinese companies.

The need for audit reform is not unique to Asian companies, and there is a global movement afoot to bring changes to the way corporate reporting is done. The Public Company Accounting Oversight Board (PCAOB), which is the body that could lead audit reform – for the US and potentially set an example for the rest of the world – has been hampered by difficulties of its own. Matt Kelly, Editor and CEO of Radical Compliance, which provides consulting and commentary on corporate compliance, audit governance and risk management, comments that the regulation of the audit industry has been weak for several years.

He describes the PCAOB as "dysfunctional" and says in the US, "we have not really seen reform – the regulator was a mess". Part of this mess saw the PCAOB Chair William Duhnke removed from his position by the SEC in June 2021. SEC Chair Gary Gensler said at the time said he was looking forward to set the PCAOB on a "path to better protect investors by ensuring that public company audits are informative, accurate, and independent." He was not forthcoming about the details of the dismissal, but there were news reports of a toxic culture at PCAOB and a story of

> To stand up to a big organisation you have to be big yourself or you could be cowed.
>
> Kevin Dancey, CEO, International Federation of Accountants

Duhnke throwing an empty soda can at another board member.

In the US, so far changes have not occurred: "They are not really doing a good job of reform of audits because the regulators have been dysfunctional. The action is definitely coming out of the UK," says Kelly. "The UK is well ahead of the curve," he adds.

For those in Asia – and the rest of the world – who have been calling for audit reform, the UK offers a beacon of light as it has gone through an exhaustive consultation process and has offered a number of proposals.

Following the corporate collapses of Carillion, Patisserie Valerie and Thomas Cook, in the UK people also asked 'where were the auditors?' In response, in March 2021, the UK's Department for Business Energy and Industrial Strategy (BEIS) announced it was launching a consultation to reform the UK's audit and governance regime.

The BEIS proposals build on recommendations of previous reviews – led by Donald Brydon, John Kingman and the Competition Markets Authority – and include requiring large audit firms to use 'challenger' firms to do a substantial part of the audit and putting a cap on the market share of large firms. Also, a new regulator would be introduced with powers to split the audit and non-audit functions of accountancy firms to reduce the risk of conflicts of interest.

On the issue of whether the Big Four accounting firms need to be broken up, Kevin Dancey, CEO of IFAC, says the companies being audited are large – with large extensive operations around the world – and the scale of the audit firm has to match. Also, points out Dancey, "To stand up to a big organisation you have to be big yourself or you could be cowed." Peterson agrees that the 'challenger' audit firms would be unable to take up the degree and quantity of work that would be necessary.

There is an issue with non-audit services and the perception that this could impact the independence of the audit firm. Dancey says that an audit-only firm would not be able to attract the right people to do a high-quality audit. "The audit firm needs to bring in expertise in other areas as well – such as tax – and you can do that within the multidisciplinary firm," says Dancey.

When asked to comment on the global trend of audit reform, Dancey says, "I think the journey of audit is always how we can do better," he says, adding that the world is evolving and the profession is always looking to make the process more efficient for all stakeholders. "At IFAC we always look at it through an audit quality lens," he says, explaining that he takes a step back and questions if any reforms will enhance audit quality or not – a different approach from those who focus on competition. IFAC has outlined the five factors it believes are necessary for a high-quality audit. These are the right process, the right people, the right governance, the right regulation and the right measurement.

On the question of how the audit process could be better, Peterson questions whether the way they are currently done has lost their usefulness to companies. He argues that the idea of a 'true and fair view' opinion has lost its value. He says that audit committees and chief financial officers would rather spend their money on a more nuanced and bespoke report that goes into detail on particular countries or departments, for example. "There are regulatory and political constraints on the firms being able to do that," Peterson says.

Also, he notes in a journal article, that the pass/fail nature of audits is too simplistic and inadequate. This is something that Kelly raises: "Audit inspections are difficult for readers to use. The audit committees do not really know what an audit inspection is telling them."

If the needs of companies in this respect are already complex, they are set to become even more so. The expectations of what corporations need to report is evolving and Dancey sees a growth in the demand for corporate reporting on environmental, social and governance issues (ESG). He says attention needs to be paid to the sustainability issues – "Sustainability is real and coming to a company near you – avoid this at your peril," he says. "The treasurers and CFOs of the world cannot treat this in siloes." They need to have an integrated approach in their company so senior management and boards can make good decisions. Also, they need to have the right reporting in an integrated and responsible way, says Dancey.

This points to a change in skills that will be needed in the future. In the UK's Brydon report there is the idea of a new professional designation of a 'corporate auditor', who could provide multi-disciplinary services across what a corporate requires. This could involve a range of subject matter expertise that will be needed from the profession in areas such as the environment and cyber-security.

In terms of the skillsets needed for this, Dancey comments that accountants are well placed to take this up because of their expertise in quantifying information and corporate reporting. With ESG reporting, for example, Dancey says "Professional accountants have the skills to deal with these issues," says Dancey.

While accountants may not be well versed in these other areas at the moment, Dancey comments this is why multi-disciplinary firms are important because they can draw on experience of others with different subject matter expertise.

These are just some of the issues that the audit profession is grappling with, both in Asia and other regions in the world. As it addresses the failures of the past, it also needs to look to the future and accommodate the evolving needs of corporates, and also move beyond the cycle of public outrage of people asking where they were. ■

Japan turns towards a digital future

Japan is both a high-tech and low-tech country, and the recent pandemic exposed the worst of its inefficiencies. In response, in part driven by the government's push for digitalisation, corporates and banks in Japan are transforming their processes.

It is the land of shinkansen high-speed bullet trains, automation, robots, and so many other innovations. Yet Japan is also burdened by a heavy reliance on cash, paper documents and the physical hanko seal to sign them.

In this respect, Japan is a mass of contradictions, which have been laid bare by the pandemic and pushed the country down a path of digitalisation.

"The Japanese factory floor is highly automated with industrial robots, but in the back office there is a huge efficiency gap. We have got robotic machines doing things, but at the same time Japan is a world leader in fax machines," says Jim Weisser, Co-Founder and CEO of SignTime.

This is something that Jaime Moreno, CEO and Founder of Mormedi, a strategic design and innovation consultancy that has worked on a number of projects in Japan, has also observed. He comments how Covid affected different economies in different ways: "It showed what was working well and what was not working well." In Japan, it exposed the manual and bureaucratic nature of many of its processes.

The public sector had become inefficient over years, with a reliance on paper and manual processes, and many outdated systems. With 1,700 local governments all with their own systems, the Covid crisis brought things to a head. "The central government realised it had a problem," says Moreno. The Prime Minister Yoshihide Suga pushed for the country to digitalise and in September 2021 the government launched the Digital Agency, which was tasked with transforming the public sector.

One issue in Japan has been the need for official documents to be signed with a hanko, or 'chop', a stamp that has a unique carving for each user. In a previous interview with **Treasury Today**, Makoto Hasegawa, Head of Transaction Banking, Japan at BNP Paribas, explained how the official corporate hanko is kept in a safe at the office and needs two people to approve its use. "The company chop does not actually match the [current] world culture, where most people are now expected to work from home," she said. This pushed the bank to find digital alternatives for its clients.

This is something that Weisser of SignTime has also been developing and his company digitises the contract process, signatures, and has an e-hanko solution. Weisser comments that in Japan it is not natural to sign something – even if you are receiving a parcel, for example. In that situation the individual would use a personal chop – which, unlike a company one isn't officially registered – and is still natural to use this instead of a handwritten signature.

Although digital signatures have been accepted and used for a number of years, Weisser says in practice people have not used them that much. "If you go to the regulator, for example, with something that is digitally signed they will say 'where's the paper version'," he says.

He still says this is a blue ocean market as there is very little market penetration. "What we find when we start talking to people and ask them if they have ever used one before, you will find they have seen it before but you rarely find someone who has signed a contract in this way," says Weisser.

Beyond the legal and regulatory recognition of digital versions of signatures, it is still hard for people to adjust. "The practice [of using it] has been the harder part," says Weisser. With a loan agreement, for example, people will still want a wet signature and a physical version, he adds.

With the pandemic, and the broader government drive toward digitalisation, however, things are likely to change. The banks are also part of this effort to help clients with the change in mindset.

It's not that Japanese banks haven't been innovative, however. In fact, the banking sector has been forward-thinking and introduced innovation that were not seen elsewhere in the world for decades afterwards. Michael Aragona, Head of Cash Product, Mizuho Americas, describes how Japan has experienced 'Galapagos Syndrome' – a term that draws on the evolutionary theory of Charles Darwin – because many technological advances have developed in isolation from the rest of the world.

As an example, Japan had a concept back in the 1980s that would now be described as a tool to enable in-house banking, says Aragona. Corporates had a terminal that connected to an automated system that pooled data and cash balances from banks and meant that treasurers could see all of their account balances on a single screen. However, this innovation only served the local market and it was dependent on the Japanese language. This kind of innovation wasn't developed or employed outside of Japan for many years.

This Galapagos effect also applies to payments, which have caused corporate treasurers – and transaction bankers – problems when dealing with Japan's domestic systems. "Corporate treasurers in the Americas or Europe have real trouble integrating Japan into their banking network – that is the biggest challenge," Aragona tells Treasury Today Asia.

One issue is the language: "Everything is done in Katakana," he explains. This has meant that some international corporates – and international banks – have left Japan out of their regional structures, such as regional treasury centres or shared service centres because the quirks of the local systems are too difficult to navigate, especially if they do not employ Japanese-English translators. And when translators are used, the translation has to be done accurately. The clearing for the instant payment network Zengin has to be automated, and if the translation is not perfect – for names and addresses, for example – the payment is rejected, comments Aragona.

Any payment that is done in English (or the Latin alphabet) is generally considered a cross-border payment – because of Japanese regulations – even if it is being done domestically. This means the charges are much higher relative to the fees for the domestic network. This causes something of a dilemma for corporates, and they must decide whether they want to invest in the translation or the services available that can bridge this gap.

Japanese banks are addressing these issues, notes Aragona, and it is possible for them to provide Katakana payment templates, which enable flexibility, get payments formatted in the right language, and also fulfil the local regulatory reporting requirements. There is also a role for fintechs to play in collaborating with banks in Japan to overcome the various hurdles of connecting to the local systems, says Aragona. "Navigating the domestic transfer market is tough, but with understanding and flexibility corporate treasurers can enjoy the benefits of both worlds," he adds.

The language is not the only hurdle to transforming treasury solutions, however. Moreno comments that the design process itself can be hindered by the hierarchy of an organisation. There is a sense, he explains, that because something has been designed or come from someone else "no one thinks of improving it" almost out of respect for what has been done before. "It requires a change of mindset," he comments. Japan does have the advantage, however, he says of being able to follow other countries that have been on a similar digital transformation journey. "It is much easier to learn from others who have done it best and do it quickest and apply it. There is already a proper benchmark for them to learn the best practices very quickly," says Moreno.

Commenting on the current state of the country's journey, David Samach, a Tokyo-based Partner at Deloitte Tohmatsu Consulting, comments that Japan's digitisation is still very much in flight. "We are seeing great advancement and activity in areas such as cloud adoption, digital currencies, automation and artificial intelligence (AI). However, this is fragmented, and there is a tremendous amount of manual activity that persists," he says, adding that this applies to both banks and corporate treasurers.

Samach continues: "Broadly speaking the local and regional banks are highly manual and in the early stages of moving towards digitisation. The megabanks are fragmented within themselves, but their payment and transaction banking offerings are based on legacy infrastructure and projects to modernise are just starting to mobilise presently." These projects will take some time, he adds, because of the need to maintain stability in the systems – any failure would have direct financial implications. "The foreign banks also play a role in this space and we are seeing increasing competition and innovation from them in Japan," says Samach.

On the corporate side, Samach comments there is more digitisation occurring in the larger multinationals and trading companies that have more complex cash management and liquidity needs, especially those who have or are implementing cloud-based ERP [enterprise resource planning] systems.

Samach comments that banks do have a lot of data already, but most have not started applying analytics and AI to their data sets for the benefit of their clients. "This will start to happen soon, and banks will be able to use predictive analytics to anticipate corporate flows of funds which could have real financial benefits considering liquidity and cash management, and anticipating future fund raising needs," says Samach.

Another area that is set to improve for corporates and banks in Japan is in trade finance. This is – like many other aspects of treasury solutions – still being done manually. Kyoka Li, Director of Sales at Surecomp – a trade finance software and solutions company – explains that from speaking to banks and corporates in Japan, "It is clear to see that – thanks to the pandemic and increasing ESG [enviromental, social and governance] pressure to reduce the use of paper documents – Japan's trade digitisation efforts are now ramping up."

Li notes there has been a lot of investment from the mega banks in Japan in blockchain and in building networks to connect to their corporates and facilitate document sharing. "However, for the regional banks and their clients who are mostly small and medium enterprises, the extent of development is limited, and banks are still servicing their clients through physical paper, fax and email-based communication and processing," says Li.

Things are changing, however, and Surecomp's SVP of Strategy, Digitisation and Business Development, Enno-Burghard Weitzel, says, "Now is absolutely the time for Japanese corporates, big and small, to start demanding change from their banks. After all, in the consumer world, Japan like all the other G7 countries, is saturated by digital services and we have come to expect nothing less. So why should it be different in business, especially in the world of trade which is fundamental to the countries' economic health and wellbeing," Weitzel says. "If banks are forced to digitise their trade finance operations in order to provide a better customer service, the corporates are not only the drivers of change, but the beneficiaries of it and facilitators of growth," he adds.

Corporate treasurers have the opportunity to be in the driving seat of the digitalisation of many of the treasury processes. With changes already afoot, perhaps it won't be long before corporate treasuries are run like a high-speed shinkanen bullet train. ■

A careful approach to risk management

Xuelin Chen
Director, Group Treasury

Trip.com Group

Past experiences have taught Xuelin Chen, Director of Group Treasury at Trip.com Group, the importance of being cautious and having a careful approach to managing risk. She describes the lessons she has learned through her career and how they have helped her manage the treasury team at Trip.com Group – particularly during the challenges brought on by the COVID-19 pandemic.

Trip.com Group Limited is a leading one-stop travel platform globally, integrating a comprehensive suite of travel products and services and differentiated travel content. It is the go-to destination for travellers in China, and increasingly for travellers around the world, to explore travel and get inspired, to make informed and cost-effective travel bookings, and to enjoy hassle-free, on-the-go support and share travel experience. Founded in 1999 and listed on Nasdaq in 2003, the company currently operates under a portfolio of brands, including Ctrip, Qunar, Trip.com and Skyscanner.

Steve Jobs, the legendary co-founder of Apple, once said: "You can't connect the dots looking forward; you can only connect them looking backward. So you have to trust that the dots will somehow connect in your future."

Something similar could be said of Xuelin Chen's career in treasury. Earlier in her professional life certain situations may not have made sense at the time, but with hindsight it is possible to connect the dots and see how they have taught

> If there is a financial product I do not understand, or I have little visibility of, I would rather not take the risk.

her important lessons. Now in her role as Director of Group Treasury at Trip.com Group, these lessons have stood her in good stead – particularly through the disruption that was brought on by the COVID-19 pandemic.

Chen graduated with a Master's degree in banking and finance, and since then has always worked in treasury. Her experience, however, has been varied and broad, and she has worked for a number of different types of companies – including family-owned businesses and multinational corporations – and in different countries. "Sometimes when I look back at some jobs, it makes sense why I worked there, but some jobs it does not! There are certain decisions I made that I'm very thankful for and glad I made that choice – they have equipped me well for my current role," Chen explains.

Along the way, Chen has watched and learned, and taken on some key lessons – especially when it comes to risk management. "Now I am in the position of leading a treasury department of 16 people I have to make big decisions and make proposals to senior management. These decisions can have a big impact on the company, and I have to be responsible for the consequences." She takes this responsibility in her stride, however, because her work experience thus far has prepared her well. Throughout her career, she explains, "I worked hard and observed other managers and the mistakes they made, and also their leadership style."

So how would she describe the style that she has adopted? Her guiding philosophy, or treasury management style, is one of caution when it comes to managing risk. This comes from witnessing the fallout when things are not going well. For example, she worked in one company where the cash position was so tight that on a daily basis she needs to decide which payments to release and which to be put on hold. She learned on the sharp end of how to manage when there is a squeeze of liquidity, but also the downside of how such tight situations can unravel. "I am very risk averse, and very humble vis a vis the unpredictability of events – and the importance of the process and the risk in financial markets, and what can happen," she says.

Chen also had the opportunity to work with one of the best treasury teams in Switzerland, which had sophisticated foreign exchange (FX) hedging programmes. Here she gained an appreciation for the disruption and unexpected losses that can occur if the market turns. "After that experience, I realised that in terms of FX management, or risk management, there is only so much you can do with financial derivatives even with a sophisticated hedging strategy – these financial products only buy time. With every hedge, there is a cash cost and an opportunity cost – that is what I have learned," Chen says.

She comments that she has also witnessed the ramifications of poor decisions by her seniors, which has also shaped her approach to risk today. In one experience – which she hopes never to see again – she saw how an investment in a financial instrument that was backed by student loans defaulted and made a huge loss for the company she was working for. "This has led to my style of being very careful," she explains. "If there is a financial product I do not understand, or I have little visibility of, I would rather not take the risk," Chen says.

What is the best way to handle this kind of responsibility, where making a poor investment decision could ruin the company? Chen says it is crucial to approach the role with clear boundaries about what it entails and what the expectations are.

"You need to have a very clear agreement on the key performance indicators (KPIs) with the senior management and the chief financial officer," Chen explains. "In the past there have been losses to a company because they have expected the treasurer to perform beyond what the market conditions are. Right now, with the billions of dollars in cash surplus, you cannot have that kind of return with no risks. You have to go with longer duration or invest in a riskier product – and then there is a risk for the company. It is such a large amount and I have to be careful and educate the senior management; we cannot get returns without trading for higher risk. They have to accept the treasurer can only do so much," she says.

It is not just the financial instruments that can land a treasury department in hot water; risk can also lie in the commercial contracts the business has signed. Again, Chen has seen the downside of this and is now vigilant about the terms of business the company agrees to. In another company she worked for, she had to untangle the foreign exchange risk the company was exposed to because of the nature of the commercial deals that were signed. The business had agreed to a contract where the price of a key commodity was fixed by a reference rate that couldn't be hedged – it wasn't linked to a price obtainable in the market. Even worse since this rate is applied to a long period after the rate is fixed, the company was left with a potentially crippling exposure.

This experience also highlights the need for the treasury team to be involved in the negotiation of contracts, much in the same way the legal or tax department would be. "The role of the treasurer should be to get involved in what our business people are signing with our partners – the way they sell and the way they buy," Chen says. One of the first things she did in her current role was to review the contracts the company had on the sourcing side – for example, with hotel groups and airlines – to ensure that any exposure could be managed. It is important, says Chen, to educate the business about such financial controls. One issue, she comments, is that the KPIs of salespeople can be very different from treasurers – they may be incentivised, with large bonuses, to sign the biggest deal possible, regardless of its long-term viability for the company. You cannot hedge a bad contract, Chen believes.

While Chen has had a varied experience throughout her career, her current role is challenging in new and different ways. She had been working in Europe and decided to return

to China at the end of 2018 to begin her role for Trip.com. "I was so excited to work for the company because it is in the internet industry," she says, explaining in the past her previous roles had been in traditional sectors, such as manufacturing or chemicals. Those businesses, she explains, typically move more slowly and had a mature business model, with a very stable market position.

Things are very different at Trip.com, which is fast-moving. It is also a relatively young company with a young workforce. With approximately 30,000 employees, the average age, explains Chen, is 28. "I feel like I'm back at university – people are so young!" she says. She was also keen to work for this company because it has a female leader – Jane Sun, the CEO of Trip.com Group – and the leadership team is also female. "That is quite unique in the technology industry," Chen says. On a personal level, she says, it is inspiring to be working for such a CEO. "You have someone to look up to – someone who is leading a US$4bn business. In Asia, I have seen this more; in Europe it is much rarer," she says, of women being in prominent leadership positions.

Also, the pace of business is very different to what she experienced in Europe. In a traditional company, for example, it could take 12 months or so for a new product to get to market. "At Trip.com we could have new products or new services on a weekly basis," she says. "With an internet company, it is so fast – it is completely different from my previous job," says Chen. And all these new products have the same treasury needs as a slow-moving product in a traditional company.

The demands of this fast-paced environment were perhaps nothing compared to the response that was needed as the COVID-19 pandemic unfolded. Chen had to steer the group's treasury through the disruption, which was particularly challenging as the travel industry was one of the most severely impacted. Although it was challenging – and difficult at times – this experience has been a highlight of her career, providing her with more lessons for the future.

China experienced the outbreak of COVID-19 much earlier and locked down at the end of January 2020. Then a few months later in March, the global equity and bond markets crashed, causing a liquidity squeeze for many companies. "That was the most disruptive moment for the company," says Chen. Trip.com was founded in 1999 so it had experienced something similar with the SARS outbreak in 2003. Unlike SARS, Covid was going to last longer than six months, however. Also, SARS was not global, and COVID-19 has had a much wider, global, impact. At the time COVID-19 started to spread, the company had an ongoing refinancing project, which at the outset Chen had expected to be a smooth process. However, because of COVID-19, it was disrupted and became very difficult and eventually took nine months to be completed.

Through this, however, Chen was able to pull off what she needed to for the company and was able to secure a US$1.3bn syndicated bank loan, and also a bond issuance. The market was very tight, Chen explains, and this had to be done in stages. Chen explains it was also difficult to manage the company's relationships with its banks and convince them that the company was solid and could withstand these unprecedented events.

Perhaps the biggest issue that Chen had to deal with was the sheer number of cancellations because of the ban on travel. "There were two million cancellations that had to be reimbursed," she says. This was an unexpected level of refunds, and also, there was a massive issue because of the delay in when the company receives the money back from its suppliers compared to the expectation of when the customers expect their refund. They have to refund the customers immediately whereas the airline, for example, which issued the ticket is still holding their money. "So, with a single event like this – if you have two million customers at the same time wanting a refund – it is a shock to the cash flow of the company," says Chen.

This obviously was a concern to the company's lenders at the time. "We were very transparent with the lenders and were able to show them the cash flow forecast and that we would be able to survive in the worst-case scenario – the company would still have no liquidity issue if they paid in their share and did the refinancing. Being so open with them was the right thing to do," says Chen.

Amid the crisis, however, were opportunities for Trip.com. In 2003, when the SARS outbreak occurred, the company was able to gain market share and the same occurred this time around. "The travel demand is still there – it is delayed and has transformed to domestic travel," says Chen. Also, competitors, particularly offline travel agencies or smaller firms, were not able to handle the cash flow shock and they have thus disappeared from the market. "For us it was an opportunity to consolidate our market position and share," says Chen.

During the most recent crisis, Chen says that it has been important to get the support from the highest level of an organisation – particularly their banking partners – and to know when to go straight to the top. When dealing with the financial arrangements, because of the urgency of the situation, it was critical to go to the senior leaders rather than deal with the credit officer in a particular country. Chen explains how she was able to reach out to the chief risk officer of the bank immediately as she knew they would have a different view on the risk of the company in this extraordinary time. Also, Chen explains, because of the company's good relationships – and the bank understanding the nature and solid footing of the company – they were able to secure US$1.8bn in financing at much better pricing than their competitors. Throughout the pandemic, liquidity was top of mind: "Cash was king – that was an absolute priority," says Chen.

With these experiences behind her, Chen now has the breathing room to look ahead to the future. One of the priorities is to focus on technology, she says. For many years there weren't many changes at the incumbent banks, with treasury management systems and SWIFT operating in the same way. But now, particularly over the last two years, there has been a lot of change, such as the use of APIs [application programming interfaces] in bank connectivity and FX trading, which were already implemented in Trip.com. Chen says she is particularly keen to make use of robotic process automation (RPA) and intends to implement this for the treasury's operational work.

As Chen prepares for the next stage of her career, with all the new technology it entails, it is difficult – like Steve Jobs said – to connect the dots looking forward. No doubt her future endeavours will provide more life lessons and the dots will connect in the future as well. ■

Be quick, be good, be gone: the treasury mantra when private equity is at the helm

Private equity investors are snapping up listed companies at an unprecedented rate with far-reaching implications for treasury teams. With private equity in charge speed is key; sacred cows are challenged, value creators prioritised and balance sheet efficiency, cash generation and return pushed centre stage.

Awash with trillions of dollars in capital to put to work, private equity investors are snapping up listed companies like UK supermarket chain Morrisons, German pet group Zooplus, US-listed Chinese recruitment group 51jobs or the ongoing circling of Toshiba. Once private equity takes the helm, treasury must buckle up for a new strategic, hands-on direction driven by balance sheet efficiency and a greater focus on working capital that puts conventional treasury on steroids. "Treasury has to respond under private equity and align to a new culture of business change and things done at speed," says Ian Fleming, Treasurer at the UK's now defunct department store Debenhams when it was under private equity ownership between 2003 and 2007. "Be quick, be good and be gone," he says, recalling his mantra at the time.

Driving factors

Years of central bank quantitative easing and rock bottom interest rates have created a world awash with capital that has private equity investors currently sitting on an estimated US$1.32trn of dry powder. "Private equity is a cyclical market that is the function of the price of assets, debt service costs and the availability of credit," says Fleming, referencing the factors linked to today's demand which although exacerbated by pandemic policy, also drove the boom in the asset class in the mid-2000s until the market crashed after the GFC.

Important other factors are also driving demand. Private equity houses target companies with robust cash flows and significant growth potential that they aim to sell within three to five years. UK listed companies, hit by low valuations compared to public markets in the US (and to a lesser extent Europe) due to Brexit and the fall in the pound, have attracted the keenest interest, but low public market valuations relative to private valuations are not unique to the UK.

Take two companies, one public and one private and both in the same industry going through a sale process, the listed company will have a lower multiple than the private one. "There used to be a premium for being listed but now the premium isn't there and even a discount may apply," explains Alvaro Membrillera, a partner in law firm Paul Weiss's corporate department and head of the firm's London office. "If you have a company going through a dual-track sale process, it is no longer a surprise that a trade sale achieves a higher valuation than the IPO."

The reason? Rigorous prepping and readying of private companies to optimise sale value leaves private firms with less value extraction down the line. Private owners have already addressed problematic issues like underperforming assets, litigation or jurisdictions that don't contribute to the bottom line.

Cash management

Private equity ownership brings a whole new angle to balance sheet efficiency that transforms cash management and working capital at a cultural, strategic, and operational level. It results in a heightened emphasis on cash and pressure on treasury to improve cash forecasting, generation and return. The cash buffers that provide comfort to many listed companies' balance sheets are quickly optimised, often replaced with a revolving credit facility to fund operations, says Membrillera. "We see this across the board." Fleming recalls that Debenhams cash profit and cash reporting strategy released £103m in working capital in the company's first year under private equity ownership.

Debt

Effective cash management opens the door to another key characteristic of private equity. Private equity investors deliberately favour robust, operational, cash flows because

they allow the highest levels of financial risk. "If you have robust cash flows you can better leverage the business," explains Fleming. "Strong cash flows allow for greater financial engineering."

Cue adjustments and optimisation of the relationship between debt and equity, all spurred on by tax breaks – like the ability to offset the cost of debt against the company's tax burden – today's low borrowing costs and using assets as collateral. "When interest rates are low there is an incentive to raise more debt than equity," says Clive Black, a director at investment group Shore Capital. "Private equity investors are after the maximum internal rate of return. By injecting debt into the financial equation rather than just being equity funded, they can get a higher return on invested capital."

Treasury becomes responsible for ensuring that the operating company can service the debt and managing the relationships with debt providers. Treasury will provide updates and rigour around communication, understand how the assets support the level of debt and be across ongoing debt refinancing of the initial take-out financing, repayment, and solvency ratios.

And now the added risk of rising borrowing costs is also in the mix, warns Black, who argues that today's private equity's tailwind is linked more to low interest rates and central bank largesse than investor talent and corporate entrepreneurship. "No doubt, as interest rates rise, we are going to see poorer investment decision and the risk of debt and leverage come to the fore."

Fleming also notes that for companies with an international footprint and revenues, treasury teams will often match the debt financing currency with the currency of its net inflows. "This can often create an overlay of hedging complexity not previously experienced or understood by management," he says.

The focus on cash and a strong cash control function often manifests in private equity investors having little enthusiasm for best practice. Providing more colour from his days at Debenhams, Fleming observes demand for treasury systems and process improvements was capped at robust, fit-for-purpose frameworks only. "Why invest £100,000 in a new TMS when you can invest in something else with an IRR of 25%?" he asks.

Hands-on

Treasury teams won't have to get involved in public reporting anymore but they should expect a new, proactive kind of governance shaped by strong board views on strategy that bring strategic, operational and personnel change. "It's nothing short of revolutionary," says Membrillera. Treasury in a listed company is one step removed from shareholders, and governance is balanced between executive and non-executive directors: shareholders don't ask to see management accounts and represent permanent capital, unlike private equity, where the joke goes, managers walk in backwards because they are looking to the exit.

Listed companies comprise a diverse group of stakeholders including activist investors seeking change but also passive investors tracking an index or those just wanting yield and a steady dividend rather than bells and whistles restructuring. This diverse stakeholder base means public companies often face resistance to close stores, move manufacturing facilities or consolidate business lines.

> When interest rates are low there is an incentive to raise more debt than equity.
>
> Clive Black, Director, Shore Capital

In contrast, private equity has much more freedom to support a company through a transition. It means treasury teams under private equity ownership are frequently called on to accelerate strategies that were impossible when the company was listed. It could be around a significant capex programme, revamping operational logistics, opening new sales lines, or refurbishing stores, all requiring capital and leverage.

Bank revamp

Private equity ownership can trigger changes in banking relationships. On one hand, large companies taken private with solid and deep banking relationships will likely keep those ties. Yet new banks coming in to finance the acquisition will also remain in the relationship going forward, and in most cases, private equity's own corporate teams design the initial financing. It leaves treasury teams with a pre-set financing package to manage including complex debt structures within a leveraged business.

Similarly, middle-range banking partners of a listed entity are often hoofed out by global players with more experience around securitisation or asset backed lending, who will then scoop up the ancillary business. "For example," says Membrillera, "a suite of regional Italian banks with long-dated and deep ties to an Italian company taken private may be displaced by large global financial institutions."

Still, it is not always the case. When the new treasurer of recently re-listed shoemaker Dr. Martens began exploring the bank relationships spilling over from the company's days under Permira's private equity ownership, he unearthed a surprisingly long list of banks: some he'd never dealt with before; a handful outside the UK and one private equity-owned lender.

The specialist skills and relentless pace required of treasury under private equity ownership has led to a spike in demand for service providers. Treasury skills in the mid cap space, a rich hunting ground for private equity firms and where companies often lack a treasury operation or specialism and everything is done by the CFO, are in demand. Skills like re-listing for example, an ordeal at Debenhams that Fleming recalls as one of the most challenging periods of his career. "Any one of the three main work streams related to the exit strategy (IPO, IAS adoption and a refinancing) would be challenging but all together, it was hard work!"

This is made easier, perhaps, by a final key characteristic of private equity and consequence of the employee mentality of old getting binned in favour of one of ownership: treasury and the finance team can expect much more generous compensation. "A Management Equity Plan will generally be more generous than the typical stock options of a listed company. The bad news is, in some cases, they will have to work much harder," concludes Membrillera. ■

Singapore powers ahead with treasury innovation

Singapore has been focused on spurring fintech innovation and building an ecosystem of players – a 'cluster effect' – to support it. As a top location for regional treasury centres, many of the latest fintech projects in the city state will have an impact on how corporate treasuries in the future will be run.

If you are lucky enough to have a good office view in Singapore, you can see the container ships approaching and leaving the port. The locals say you can judge the state of the global economy by how many ships there are; if it looks busy, business is booming.

Singapore has long been a trading hub and in recent years has been building the infrastructure to match it. Multinationals and international banks have set up regional offices there to support the financial transactions for the physical trade that can be seen from their windows.

Singapore has been able to reinvent itself throughout its history, says Zennon Kapron, Founder and Director of Kapronasia, a consulting firm that focuses on the fintech industry. "It is a small country with very few natural resources. It has always had a story to drive growth: 15 to 20 years ago it was biotech; ten years ago it was tech, and now it is fintech," he says.

And the focus on fintech is creating an incredible amount of economic growth, he says, and a number of the Southeast Asian unicorn companies – high growth tech companies with a valuation of more than US$1bn – have a presence in Singapore.

It is an attractive place to do business because of its infrastructure, tax regime, and the 'cluster effect' that has been created by having start-ups, multinational corporations and international banks all in such close proximity.

This has been proactively managed by the government and the Monetary Authority of Singapore (MAS) has pushed for Singapore to be a fintech hub – both in terms of the innovation and building an ecosystem. The city state currently has more than 40 innovation labs and more than 1,000 fintech companies. MAS sees the financial sector as an integral part of Singapore's ambition to be a smart nation, and it's not just about fostering innovation – it's about having a purpose as well.

At the Singapore Fintech Festival in November 2021, MAS Managing Director Ravi Menon said, "The future of money, finance, and the internet will have far-reaching effects on economies and societies. It is important that public authorities and the financial and technology communities work together to shape that future, so that money, finance, and the internet can be forces for good, helping to expand economic opportunity, enhance social inclusion, foster stability, and protect our planet. Ultimately, money, finance and the internet must serve the people who use them."

Premdeep Shah, Deutsche Bank's Corporate Bank Head of Fintech and Platform Coverage for ASEAN, comments how Singapore is a vibrant place when it comes to fintech, which has been supported by the government and the policies of MAS. "Singapore is a powerhouse of innovation," says Shah, adding that its small population means that it is a testbed of the latest consumer trends, which can then get rolled out to ASEAN and beyond. "The adoption of technology is very strong in Singapore," he says.

With the latest fintech trends, Shah says, "corporate treasurers may think that innovation and disruption primarily affects start-ups – or fintech themselves – they might not think it is relevant to them, but that is not entirely true," says Shah. There are companies that are at the forefront of this innovation, he says, and "these companies do not have to be in the fintech space".

Kapron comments that he has observed a shift in the habits of treasurers and their approach to fintech. Only a few years ago, he says, the idea of approving a US$2m transaction from their phone seemed foreign, for example. "Now they are comfortable with this and high-value transactions have come to the mobile phone – they can sit at lunch, approve payment. There has been a change in mindset," he says.

Now the major trend around innovation is about insight, says Kapron. Treasurers want these high value transactions to go through at relatively high speed – real-time payments, the infrastructure of which is already in place – but the speed is not so sensitive in high-value transactions, says Kapron. "The change is in the opportunity to better analyse the data around treasury and cash management and to be able to act on that in an automated way," he says.

There are a number of innovations coming out of Singapore that are relevant to treasurers. Shah notes that one is using blockchain for supply chain financing. An automaker that purchases headlights from a supplier, for example, is now able to use supply chain financing – through the use of distributed ledger technology (DLT) – for its supplier, and its supplier's supplier, or even one level below that, comments Shah.

Rahul O'Verma, Asia Pacific Head of Innovation for Treasury and Trade Solutions, Citi, comments on the other items that belong on the list of treasury innovations. These include the rise of digital assets; embedded finance and how it is driving direct-to-consumer growth; the coming age of healthtech;

and using fintech to make better decisions around environmental, social and governance (ESG).

Citi has set up a new digital assets unit and is ramping up hiring to boost expertise in blockchain, digital assets and digital currencies. Those hired will be based in Singapore, as well as other cities, he explains. The bank has also boosted its capabilities for instant payments, and been involved in hackathons and accelerator programmes. It has also partnered with API Exchange to tap into the ecosystem of fintech firms and be able to deliver a range of solutions – via APIs [application programming interfaces] – more quickly.

Such initiatives reflect how transaction banks in Singapore are exploring a number of areas of innovation to support their treasury clients. Deutsche Bank's Shah comments on how other fintech trends in Singapore have a bearing on what treasury innovation looks like. "Buy Now Pay Later is a trend that is particularly hot right now in Singapore," says Shah, and is relevant to corporates that sell directly to consumers. Companies that do not have this firmly embedded into their payments and collections may face challenges in getting it off the ground, he says.

Also, embedded finance – a trend that O'Verma at Citi also identified – is becoming more relevant and enables non-financial companies to offer financial products. Shah gives the example of a ride-hailing app making it possible to book a journey and an insurance policy at the same time. The insurance lasts for the duration of the journey and could cost as little as 30 cents, for example.

Deutsche Bank has a number of large digitally-native companies among its clients. In developing solutions that support the needs of these innovative companies, the bank is able to feed the latest trends back into the product development for its clients in more traditional industries, such as manufacturing. This is a way of "bringing the new economy back to the old economy", says Shah.

Linking new innovations and bringing it into traditional institutions is always a challenge, and Standard Chartered has developed a way to experiment with the latest technologies in a way that is unencumbered by the legacy processes, systems – and thinking – of the traditional bank.

SC Ventures, as the innovation unit of Standard Chartered, is run independently from the main bank and this means that it can innovate more efficiently, explains Harald Eltvedt, SC Ventures' incubation lead. It develops solutions on its own and has also collaborated with corporate clients.

In a sense, SC Ventures is able to prototype some elements of what the transaction bank of the future might look like. Eltvedt comments that at SC Ventures they are experimenting with business models – sometimes by themselves, sometimes with partners – and the main bank benefits because they are able to innovate in a more agile way.

As it innovates, Standard Chartered has an eye on the potential future needs of its clients in both the physical and the virtual worlds: "We see ourselves as the bank of the metaverse," he says. He explains that the bank is preparing itself so that it can be relevant in this future. Although no one knows what the metaverse will actually look like, SC Ventures has six principles – or high conviction themes – to guide it through its innovation. These are focused on being a digital bank; e-commerce; supporting SMEs; digital assets and tokenisation services; capability as a service; and sustainability and inclusion.

> We see ourselves as the bank of the metaverse.
>
> Harald Eltvedt, Incubation Lead, Standard Chartered's SC Ventures

Eltvedt comments that the digital bank is about providing a digital banking platform – that enables others to plug in via APIs – that can support the "online, mobile-first, instant-gratification world that we're now in".

With the online commerce and payment solutions, Eltvedt says, "It might seem late in the game, but it is really needed. We actually saw during the pandemic the migration to online commerce accelerated – particularly in emerging markets where there was a transition to online banking and online payments at a much greater pace than other economies," says Eltvedt.

One successful venture to come out of SC Ventures is Zodia Custody, which provides custody for crypto assets and enables institutional investors to securely invest in this new asset class. And on the trade side, SC Ventures invested in Linklogis, a Chinese supply chain finance technology company, which launched an initial public offering (IPO) in January 2020. They also formed a joint venture to create Olea, a digital trade finance origination and distribution platform. Eltvedt explains this platform puts suppliers, who are mostly in China and Southeast Asia, in touch with institutional investors anywhere in the world. "Blockchain can track the securities that are being created and where the investment is going," he says. "It tracks everything in a visible and authenticated way, and creates more transparency between suppliers and potential investors."

And when it comes to capability-as-a-service, SC Ventures has developed Standard Chartered nexus, a white label solution that allows other organisations – including corporates – to use its infrastructure. "We have an institution that has been around for a long time – there are certain things we know how to do well," he says. Through open banking, and a 'plug and play' model, "We provide our capabilities to other players so they can manage their own system, their own lifecycle and they do not have to do the governance and all the security themselves," he says.

SC Ventures is currently testing a use case for this in Indonesia, Eltvedt explains. When asked what kind of company would want to use Standard Chartered's software-as-a-service in this way, he says that it could be a company that wants to transition to online commerce and manage the transactions itself and run its own loyalty programmes, for example.

With such a hotbed of innovation on its doorstep, treasurers in Singapore have a wealth of options to explore and apply, as well as the opportunity to explore what the treasury of the future will look like. And, if they are lucky, they might also have a nice view of the ships from their window. ■

Driving sustainability in treasury

Corporations are continuing to place more focus on sustainability and ESG – but how can treasury teams embed sustainability into their activities? From green bonds and sustainable SCF to paperless processes and digital signatures, there's no shortage of opportunities for treasurers to further the sustainability agenda.

The importance of sustainability and Environmental, Social and Governance (ESG) considerations to multinational corporations continues to grow. Seventy per cent of respondents to **Treasury Today's Global Sustainability Study 2021** said that sustainability is reflected in their organisations' core values, while 76% said that sustainability is now a board-level issue. Half of all respondents reported that their companies have a sustainability 'champion', and almost a third have committed to net zero.

"In a relatively short period of time, ESG has gone from being something that's at times been seen as a standalone agenda item to absolutely central, and increasingly embedded as a core part of planning and strategy. It's increasingly integral to every decision our customers make," says Andrew Blincoe, Head of Corporates and Institutions at NatWest. "The increasing focus on ESG continues to be driven from across the range of stakeholders: by customers, colleagues, by boards and executives."

> ESG has gone from being something that's at times been seen as a standalone agenda item to absolutely central, and increasingly embedded as a core part of planning and strategy.
>
> Andrew Blincoe, Head of Corporates and Institutions, NatWest

In addition, the expectations of potential future employees represent another driver for focusing on ESG. "We're all seeing this huge positive shift in mindset around ESG," says Chris Jameson, co-head of product management for GTS EMEA at Bank of America. "The next generation of talent isn't going to sign up to a company that doesn't have strong ESG credentials, and live up to those credentials."

Embedding sustainability

For treasury teams, likewise, ESG is an increasingly central priority. PwC's 2021 Global Treasury Survey, for example, identified 'Driving ESG' as one of five top priorities for corporate treasury, alongside business partnering, raising digital acumen, optimising cash and financial risk.

However, there are a number of ways that treasury teams are working to embed sustainability and ESG considerations. Green and sustainability-linked bonds and loans are becoming increasingly mainstream, as Treasury Today's Global Sustainability Study illustrated: 27% of respondents had used a sustainability-linked loan or RCF, while 26% had used a green bond. All respondents said they had signed up to ICMA green bond principles.

At the same time, the scope of activities included in sustainability has become much broader. "It's interesting to look at the evolution of the types of financing included in this topic," says Blincoe. "If we go back a little while, we primarily saw the ESG financing agenda emerge around raising green bonds. Now the focus is not just on conventional capital raising – it's much broader, including, for example, driving ESG through all parts of the supply chain." As Blincoe points out, companies are looking not just at their own carbon footprints and ESG targets, but also at the materials they use, and the carbon footprint of their suppliers.

Rise of sustainable SCF

The importance of the supply chain to a company's sustainability was highlighted by Treasury Today's Global Sustainability Study, with 48% of respondents including supply chain selection and management as a KPI to monitor ESG performance.

With more companies seeking to make their supply chains more sustainable, the use of sustainable supply chain finance (SCF) continues to grow. In a recent webinar with NatWest, Alex Ashby, Head of Markets, Group Treasury at Tesco, explained how the retail group has integrated sustainability into its supply chain finance programme, with suppliers able to access lower funding costs if they are performing well against their sustainability goals. Other companies, likewise, are turning their attention to the opportunities of sustainable SCF programmes.

"There are a number of ways that you can use supply chain finance in this regard," comments Duncan Lodge, Head of Traditional Trade, and EMEA Head of Trade & Supply Chain Finance Product Management at Bank of America (BofA). "Yes, you can think about tiered pricing for suppliers that meet certain criteria. But it's also a very flexible tool, and we're seeing it used in a number of ways within our client base."

For example, says Lodge, companies might consider sustainability when deciding which suppliers should be given access to an SCF programme from the outset. "This might mean focusing on suppliers that are meeting ESG criteria – or it might mean isolating a specific flow within your supply chain," he explains. "An energy company, for example, might choose to empower the suppliers that are part of their wind turbine supply chain."

Transactions and investments

Beyond finance, other areas may present opportunities for treasurers to embrace sustainability. In the transactions space, for example, digitisation can be harnessed to reduce the prevalence of paper – and, indeed, plastic.

"The most visible place for people to start has always been paper," says Jameson. "Whether that's bank statements, cheque processing or physical cash collection, the drive from paper to electronic has really been accelerated by the Covid pandemic." He explains that the adoption of digital signatures has been a significant shift, alongside the adoption of mobile wallets and online self-service tools. And where plastic is concerned, he notes, companies are increasingly shifting towards virtual card payments.

ESG also has a role to play in investment decisions. As Jameson explains, treasurers are already looking to weave ESG into their investment approach – and in a rising rate environment, "it will be very important not to lose sight of the ESG approach in an investment strategy, and not to give way to yield alone."

Seeking consistent standards

It's clear that there are numerous opportunities for treasurers to drive sustainability across their activities. But in this rapidly evolving area, there are also a number of obstacles that treasury teams need to consider.

"It can be quite overwhelming," comments Christian Aue, VP Corporate Finance at Dürr Group. "You have a lot of changing regulation and market demands, and you need to keep on top of those – especially with the taxonomy adding new criteria. It can be challenging for mid-to-small-sized treasuries to address these topics."

Blincoe says that while there is some progress towards consistent standards from a governance and reporting perspective, "We are very much on the journey." He notes that most large corporates are evolving their own views about how they can make a difference, and how their activity should

be appropriately measured. "Unsurprisingly, though, we continue to see appetite from across the spectrum for consistency in reporting metrics – investors are asking, 'How can we read across one company's ESG viability and compare it to another one?' The criteria they are using to measure themselves are quite different."

Efforts are underway to address these issues. Blincoe points out that some standardisation is under way across different asset classes, for example among banks working on syndicating loans. "We continue to see progress towards developing a consistent view across customers and sectors, and it's interesting to see how finance will converge around the transition to net zero. Measuring carbon will be one of the issues at the heart of mobilising finance," he adds.

Enabling change

Where transactions and trade are concerned, the speed at which treasurers can enact change is another possible hindrance. "Systems are notoriously costly to change – and if you're going to bring in new payment mechanisms that are more ESG friendly, there's a cost to that," notes BofA's Jameson. "Processes may be quicker to change, but it can take time to ensure the governance is in place and get buy-in from the team." In addition, he notes that it takes time and effort to change a consumer's behaviour – for example, by asking them to make payments using a different channel if they have historically posted cheques.

Addressing the proliferation of paper documents that is still associated with trade transactions has also long been regarded as a challenge. But as Lodge notes, "Fortunately there are a number of key ingredients now coming to the fore that make digitisation increasingly achievable, including the rule of law."

For one thing, the G7 model law on electronic transferable records (MLETR) is currently being written into country law by some of the G7 members, which is intended to enable the legal use of electronic transferable records domestically and across borders. In addition, last year the International Chamber of Commerce released its Uniform Rules for Digital Trade Transactions (URDTT). "Having a framework for what happens when documents of title move between counterparties is really important, as it gives companies and banks confidence as they start to adopt these digital alternatives," says Lodge.

Enablers of progress also include the rise of ecosystems such as the Marco Polo network, in which multiple counterparties come together to drive digitalisation and agree on common standards. Blockchain, too, may have a role to play in helping to remove paper from trade processes and drive digitalisation.

Another challenge is the issue of greenwashing, and the question of how to define what does or doesn't qualify as ESG. "The good news is that there are established ESG consultancies and rating agencies, and many of these have experience of supporting trade finance transactions and facilities," says Lodge. "There are also a number of second party opinion providers out there that can assess your internally-created ESG criteria, and give you confidence that what you're doing does indeed achieve the goals that your company is striving for." ■

Achieving excellence in ESG

Global mechanical and plant engineering firm Dürr Group was recognised as the Highly Commended Winner in Best ESG Solution in the 2021 Adam Smith Awards. The winning solution centred around the issuance of the company's third sustainability-oriented Schuldschein loan, in which the company achieves a lower financing cost once ESG targets have been reached.

Speaking about sustainability more broadly, Christian Aue, VP Corporate Finance, says that sustainability is one of Dürr's key enablers – "and one of the most important aspects of this is to enable our customers to be sustainable themselves." Where treasury is concerned, he says the value treasury can bring to the organisation is by putting a spotlight on the topic of sustainability. "Also important is the way that you communicate with your bank, because you need to be credible in what you're doing with sustainability," he comments.

In recent years, he says, banks have built up their expertise on this topic. "They are also shifting their product focus to be able to offer treasury solutions which are sustainable or green. And of course, they also now challenge you, because it's getting more and more important for them to think about how they build up their customers."

But as Aue notes, this is not a one-way street. "We are reviewing all of the products we use, and also our partners, in terms of how they are engaging with sustainability. So it's not just the banks asking us about this topic – we also expect our banks to act in a sustainable manner. And we are also reviewing all of our projects to see where we can instil the topic of sustainability."

Nevertheless, Aue points out that not every area of treasury should be infused with a sustainability element. "We've discussed some products where we've decided not to go ahead, because it doesn't make any sense for us to do it."

RATES OF CHANGE

Uncertainty around interest rate rises has not yet added significant complexity to the transition from LIBOR pricing, but experts warn of the impact of further rate increases.

According to a recent report from Coalition Greenwich, the combination of interest rate hikes and the move away from LIBOR pricing has the potential to create anomalies in commercial loans over the coming months.

Assistant Director Financial Advisory at Deloitte, Svenja Schumacher, acknowledges that the ability to forecast interest payments due to the backward-looking nature of risk free rates has become more difficult.

"For example, if someone took out a loan on £6m LIBOR beginning December 2021, they would know in December already how much interest would be due in May 2022," she says. "A loan on SONIA, in comparison, would have already captured the two interest rate hikes from December and February through higher daily rates, which are compounded to make up the final rate."

This also leaves the borrower with further uncertainty with regards to the March and April Monetary Policy Committee meetings, which could increase the rate further.

Given the lack of experience of how SOFR or other risk free rates behave in a hiking cycle, borrowers still trying to get their heads around how the new rates will be impacted by rising interest rates, says Ulrich Lotze, Head of Risk & Platforms Financing Risk at Standard Chartered.

"Asian banks are still calibrating how to accurately measure funding costs and how to translate that into liquidity premia for floating term pricing," he adds.

On the upside, the yield curve for most currencies was flat in 2021 and this meant that differences between forward looking term rates and overnight compounded rates were minimal, explains Shankar Mukherjee, UK Ibor Leader at EY.

It should also be noted that communication from the Bank of England on the use of SONIA compounded in arrears stated that "calculating interest on a compounded basis reduces the contribution of 'one-off' volatility in interest rates that may occur due to unusual supply and demand factors affecting a benchmark rate on a particular day" observes Stephen Farrell, Audit & Assurance Partner at Deloitte.

Another benefit of the risk free rates is that they tend to reflect the central bank's actions more effectively.

"When the Bank of England cut interest rates at the beginning of the pandemic in 2020, SONIA perfectly followed those rate decreases whereas LIBOR – whilst following those movements initially – developed in the other direction," says Schumacher.

Whilst both indices generally reflect the underlying development of interest rates, LIBOR also includes an implicit credit premium for the banking sector which can increase significantly in times of market stress.

The lack of historical data around the behaviour of the new risk free rates has been a key challenge in pricing, model development and validation. In the face of this, various proxy methodologies have been used and their performance will be tested as we enter a more volatile interest rate environment.

"Of course, the new risk free rates are designed to be different since they do not have a credit component, so how they perform particularly in stress periods will be interesting and a key input into product pricing and model refinement," agrees Mukherjee. "However, a steeper yield curve environment going into USD transition over 2022 and 2023 means there may be additional challenges."

Schumacher concludes that it is important to keep in mind that Libor was discontinued in the first place because of market manipulation "so having a benchmark which is underpinned by actual transactions is an overall positive outcome for all market participants." ■

Cash pooling

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

Susan Hillman
Founder and Partner
Treasury Alliance Group

Cash pooling has different flavours. Companies can pool in-country or cross-border. It is the latter that appeals to multinational corporations because it allows them to maximise their credit and offset positive and negative balances across different legal entities. There are two approaches: physical and notional.

Physical pooling allows funds in separate subaccounts – at the same bank – to be automatically swept to and from a header account. The participating entities' bank accounts are either in surplus or deficit position on an end-of-day basis. The physical concentration to the designated header account effectively zero balances the subaccounts. Physical pooling can be used across multiple legal entities, located in the same or different countries – but on a currency-by-currency basis. The idea ensures that a company doesn't have one entity overdrawn on the same day that another entity, in another jurisdiction, has excess cash. Everything is swept at the end of the day, and the next morning funds cover outgoing payments for the overdrawn entity.

Movements between accounts in this way are categorised as intercompany loans to and from the header entity and the participating subsidiaries. Specific loan documentation related to the pool structure is prepared in advance. The holding entity should be designated as an agent for the group which allows the interest paid and earned to be treated as bank interest and is not subject to withholding tax.

Notional pooling achieves a similar result but is accomplished by creating a shadow or notional position resulting from an aggregate of all the accounts, which can be held in multiple currencies. Interest is paid or charged on the consolidated position. There is no actual movement or commingling of funds. It is a seemingly simple, hands-off solution; but the opaque nature of the arrangement in terms of costs and minimal documentation between separate legal entities makes many tax directors uncomfortable.

Most multinationals prefer physical pooling as it is cleaner from a tax perspective because those movements to and from the header accounts are characterised as loans. Cash pooling is day-to-day cash management – if you have an operation that needs funding on an ongoing basis, either handle through a capital infusion or a direct intercompany loan with specific terms and conditions.

Physical pooling is typically done with one bank, and companies must decide which of their banks is going to manage the daily cash positions and liquidity. There are only five or six banks globally that can effectively offer this service and have the reach and reporting platform required.

Cash pooling can reduce costs as companies are not paying fees to multiple different banks or doing wire transfers to fund operations or move excess cash – however the real value for companies is in administrative saving and cash optimisation. Cash pooling also eliminates overdraft charges and in times when interest rates are higher, companies can get a return on their cash. Still, there is a cost to a pooling arrangement and pricing may differ between banks.

Can third-party vendors provide pooling services? Information and transaction tracking potentially, but I can't see banks being pushed out of the picture. Banks hold the balances and provide the credit lines that are normally behind this type of service, so I'd advise companies to give this service to one of their credit banks that can offer cash pooling. It is good transactional business and can provide balances and liquidity for the banks which is required from a regulatory perspective.

Manish Joshi
Director, Cash & Banking Operations, META
GE Corporate Treasury

Cash pooling enables companies to efficiently use their own money, and drives working capital management. As a rule of thumb, companies would prefer to use their own money rather than borrow from financial institutions, so pooling also reduces the cost of capital. Cash pooling also helps ensure that funds are available when needed, helping to smooth the payments process.

As a structured approach, companies can focus on cash consolidation at a country level first. This works best for a country that has multiple entities and business lines enabling better use of cash within the country for the purpose of payments, efficient collection, and consolidation. The process also involves defining the optimum requirement for cash at a country level and determining the core surplus which can be utilised by the wider company for cash management around the globe.

Cash pooling drives efficiencies in terms of companies' ability to use their own funds. For example, in emerging markets in places such as Africa, cash pooling and collections in local

currencies are often used for local payments and expenses as soon as possible to reduce FX exposure and protect against the risk of currency devaluation.

Cash pooling is a strategy that can be used to manage FX exposure, excess liquidity, and country and bank counterparty risk. By extension, companies shouldn't shy away from borrowing in local currencies either. If collections and expenses are in local currency, companies may think about borrowing locally to fund the business to protect against the risk of devaluation. Local currency borrowing costs are preferable to the implications of FX devaluation.

It is simplest for a company to use one bank for its pooling needs, but this isn't always possible because banks have footprints in different countries. Different regulatory requirements and product development can also require companies use the services of multiple banks to pool. Companies need to set up cash pooling between these different paradigms. Many countries still prohibit cash pooling, particularly those with low dollar reserves or with economies that are import-dependent.

Lori Schwartz

Global Head of Liquidity & Account Solutions
J.P. Morgan Chase & Co

All companies need cash to support their business and make payments. This liquidity is an important risk mitigant, but excess liquidity can also be inefficient when seen in the context of capital that the company hasn't deployed to invest either in the company or the yield curve.

Solutions like physical cash pooling connects accounts and corridors of activity, moving cash in between accounts to ensure treasury has cash where it needs it and when, in the right currency, and able to cover short positions or aggregate long positions. Notional cash pooling is similar but doesn't involve physically moving cash. It creates a fungibility across currencies and provides visibility, control, and optimisation. Companies can also integrate virtual account solutions that retain the integrity of data and information on that underlying position.

Cash pooling is vital for optimising cash on account. Take a multinational with decentralised operating entities running their own businesses. These subsidiaries will keep their own cash buffers to mitigate risk and ensure they can make their payments that when added together, combine to make a significant sum across a global company. Yet not every operating company needs their buffer every day. As companies go on a journey of centralisation, they will create a fungibility in those cash buffers. It means that different entities can have a cash injection according to their needs, creating a central buffer that is optimised – and reduced – at a treasury centre.

When companies migrate from a decentralised to centralised structure, they can reduce the need to keep cash on deposit by up to 50% from simple efficiencies. Treasury can see what cash it has and where it has it, giving real-time control that allows companies to take that surplus capital and invest it to accelerate the business growth.

Of course, the cost of capital fluctuates in any given economic cycle, but companies benefit from reducing the amount of capital whatever the cycle because reducing capital is a value add. We saw a huge demand for pooling in 2020 when the business cycle changed and companies realised they would benefit from a centralised structure, with visibility and control of their cash.

Technology and digitisation are also driving pooling demand. Digitisation has led to an acceleration in e-commerce, giving way to faster payments and causing money to move much more quickly, putting pressure on liquidity management. Corporate treasury needs to know where cash is and have access to it. For example, one of the biggest challenges within cash management is short-term forecasting. It has created a need for structures that can respond and allow treasury to put cash where it is needed and in the right currency.

In another example, the evolution in e-commerce means more companies are selling third party goods and need to manage third party monies (3PM). It means these companies are an intermediary in a cash exchange. We increasingly work with companies to structure liquidity and account solutions that support 3PM which often involves safeguarding cash and requires even more visibility and control. ■

Next question:

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

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

Time for narrow banking?

With the world in turmoil, and the threat of inflation raising rates thereby making historic debt loads unsustainable, not to mention little understood derivative risks at banks, treasurers face a tough time as guardians of company cash and guarantors of liquidity. This is a good time to revisit the repeal of Glass-Steagall in 1999, and even further to consider the merits of narrow banking.

Narrow banking

The term narrow banking can cover a variety of bank structures, ranging from Glass-Steagall era "banks" which did run loan books but were excluded from investment banking activities to banks which place all their deposits as deposits in turn with their central bank. The latter – more narrow definition – means not participating in fractional reserve banking aka printing money.

Of course, the more narrow definition is close to what might be achieved with Central Bank Digital Currencies (CBDCs), depending how it is implemented. CBDCs are much discussed but remain in pilot mode in a few jurisdictions. Responsible central bankers state that implementing CBDC should be a political decision, not a central bank decision, and there are many objections to CBDCs – not least that most of the societal benefits can be achieved through other (less disruptive) means.

Of course, with (most Western) governments inundated with historical debt levels (which keep growing to new highs) and untenable pension and health care obligations, a sceptical treasurer may have reservations about even central bank money. But for now, unless they want to hold gold or more dubiously cryptocurrencies, fiat currency remains the only liquid and generally accepted medium of exchange.

Benefits

For the purposes of this article, "narrow bank" will refer to the more narrow bank described above ie a bank that places all its customer deposits with its central bank, and does not engage in lending, securities, derivatives, etcetera.

Such a bank can serve corporates with deposit (store of value) and cash management services (exchange of value) services, but not lending, trading, issuance, hedging, etcetera.

From both deposit and cash management perspectives, a narrow bank offers considerable benefits for corporates.

Start with deposits. Treasurers usually think about investments in terms of the acronym SLY (security, liquidity, yield):

- Security (do not lose cash).
- Liquidity (keep cash available).
- Yield (earn interest on cash).

Security

For now, central bank funds – despite the risk of inflation devaluing fiat currency – remain the most secure and liquid store of value potentially available to treasurers.

In the past decades, amidst rolling banking crises, a number of large corporates have applied for banking licences primarily to gain access to central bank deposits. But this is an expensive and complex method that is only available to very large corporates, and the cost, complexity and risk of banking licences only keeps growing.

From this perspective, a narrow bank offers near direct access to central bank funds, and therefore the most secure store of value possible within the constraints of fiat currency.

Liquidity

As for security, so for liquidity. There is no more liquid investment than central bank funds. The scale and ubiquity of

fiat currency mean that they have higher availability and lower costs than any alternatives such as securities, gold, cryptocurrencies, and so forth.

Since a narrow bank will not be lending out funds, and therefore has no liquidity gap and no risk of a run on funds (because corporate deposits are in turn deposited with its central bank), narrow bank deposits represent the most liquid investment product imaginable within the constraints of fiat currency. Currently, most treasurers consider short-term sovereign debt (eg US Treasury Notes) to be the most liquid investment, but even these most liquid instruments require a well-functioning trading market, and we have seen these dry up (eg 2019 Repo crisis).

Yield

Treasurers fully understand that SLY is in order of importance, and they know that loosing cash or not having cash available are unacceptable outcomes. But yield is the easiest metric to measure and in practice often the most discussed. And many would fear that a direct pass through to central bank funds would offer unexciting yields.

Indeed, narrow bank deposits preclude playing the yield curve and arbitraging credit risk. And they effectively preclude outsourcing those things to lending banks, which is the current reality. On the other hand, the capital costs and organisational complexity that arise from lending and fractional reserve banking impose huge costs on lending banks, and those costs are passed on and marked up to corporates and other customers.

While a narrow bank is precluded from tenor and credit risk arbitrage, it has a great opportunity for cost arbitrage. Thus a narrow bank can compete effectively with lending bank demand deposit offerings.

Accounting

Narrow bank deposits will be treated like other bank deposits – at par. This makes them more attractive from an accounting perspective than high liquidity money market funds (liquidity funds), which are commonly used by corporates as a store of value.

Ever since Reserve Primary Fund 'broke the buck' in 2008 (its net asset value fell to $0.97), regulators and accounting bodies have busied themselves dreaming up ever more complex rules and revaluations to dispel the illusion that liquidity funds as are good as cash. This is certainly a good thing from the perspective of financial transparency, but it has brought more work and cost to treasurers using these instruments. It has also increased the costs of running liquidity funds themselves, thereby reducing yields.

Narrow bank deposits offer all the benefits touted by liquidity funds, with both lower costs and higher security and liquidity.

Cash management

Many of the benefits of narrow banking as a store of value in terms of security, liquidity and yield apply to cash management as well. To the extent that balance management (cash pooling in its various forms) result in credit balances, the benefits are the same. (A narrow bank will not be able to offer overdraft on balance management products because it is precluded from lending.)

From a payments perspective, the benefits of security and liquidity are obvious. The lower regulatory and organisational overheads of narrow banking, together with the absence of legacy technology stacks, would enable it to be fully cost competitive with full banks.

From a network perspective, assuming that narrow banks will be start-ups, they may not have the global reach of some of the largest full banks. On the other hand, we seem to be seeing a radical withdrawal from global banking by most large full banks, as they decide to focus on core and profitable markets. Further, the evidence from the success of retail FX and payment banks such as wise.com shows that they can be very competitive in both cost and reach by availing the services of their partner payment service providers.

Conclusion

It may take a while to become common, but it is clear that simpler banking – and especially narrow banking – can offer many benefits for treasurers and their employers. ■

David Blair, Managing Director

Twenty-five years of management and treasury experience in global companies. David Blair has extensive experience managing global and diverse treasury teams, as well as playing a leading role in eCommerce standard development and in professional associations. He has counselled corporations and banks as well as governments. He trains treasury teams around the world and serves as a preferred tutor to the EuroFinance treasury and risk management training curriculum.

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