May/June 2022

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Belt and Road tightening

China's lending to Belt and Road projects has dropped dramatically, but the level of debts is much greater than previously thought.

The Corporate View

Steve Wong

Executive Director & Asia Treasurer
Adient

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It has never been more important to recognise and reward the very best and brightest in corporate treasury.

Investing

MMF reform is once again on the horizon

Treasury Practice

Minimising the pain of treasury integration

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Sophie Jackson & Meg Coates

EA to the Publishers
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Editorial
Sarah Rundell

Head of Production & Client Delivery
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Circulation Manager
Sophie Friend

Digital Content Manager
Joanna Smith-Burchnell

Senior Designer
Dawn Ingram

Founder & Director
Angela Berry

Chair
Richard Parkinson

Switchboard	+44 (0)13 0462 9000
Publishing	+44 (0)13 0462 9005
	+44 (0)79 4665 6656
Memberships	+44 (0)13 0462 9013
Advertising	+44 (0)13 0462 9018
Editorial	+44 (0)13 0462 9003
Production	+44 (0)13 0462 9019

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memberservices@treasurytoday.com

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A season of reflection

As we reach our third issue of 2022 we are also approaching our Adam Smith Awards Asia season, with nominations opening in June. Recent years have seen treasurers across Asia Pacific tested and many of you triumphing with innovative and collaborative solutions to the problems of our time. We would like to invite you to nominate yourselves and your teams for our best practice in corporate finance Adam Smith Awards Asia, the industry benchmark for excellence.

In this edition we explore China's lending practices as lending to the Belt and Road Initiative slows and conversely Chinese lending is purportedly far higher than previously estimated. What does this mean for future relationships and how has this developed? In a separate China focus we also take a look at China's crackdown on companies fundraising via IPOs. Given this restriction, what are the other options?

We focus on money market funds, the trajectory of which has been complex. As they are put under a microscope again from global regulators what does the future hold in store for these funds and what alternatives should treasurers be cognisant of?

The payments space is explored, with ISO 20022 put under the microscope as we assess how treasuries can get prepared. We also look at the practice of treasury integration following merger or acquisition in our treasury practice feature and assess the latest technological tools in modern treasury and their effectiveness.

Finally we explore the circular economy and its link with international trade as sustainable practice and trade co-exist. This development has the potential to transform the manufacturing process and we take a look at which treasury teams are getting involved.

As ever we are excited to bring you the latest industry developments and look forward to hearing more about your new challenges and successes as the season continues.

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China tightens Belt and Road lending

Chinese lending to Belt and Road infrastructure projects has dropped dramatically, calling into question the sustainability of the initiative. And with accusations of 'debt trap diplomacy' persisting, what does the future hold for the project and debtor countries that struggle to repay their Belt and Road loans?

The Belt and Road Initiative is an ambitious project, a grand vision for Chinese overseas development to connect Asia with Europe and Africa – a modern-day Silk Road with networks both on sea and land. But like someone whose eyes were bigger than their stomach at a buffet, China has had something of a lending binge that is now being corrected.

The project has entered a period of belt tightening and Chinese lending to the Belt and Road Initiative (BRI) has dramatically fallen. Like the buffet, items have been left on the plate and cast aside; partially built roads lead to nowhere and borrower countries have been lumbered with useless 'white elephants' and debts they are struggling to repay.

This picture of the BRI has called into question its sustainability. And the fall in lending has been dramatic: according to figures from Boston University, Chinese overseas lending was US$3.9bn in 2019, a fraction of the US$75bn that was recorded in 2016.

Yunnan Chen, a Senior Research Officer in the Development and Public Finance programme at think tank ODI, explains that data from numerous reputable sources shows that Chinese overseas lending has dropped. "The reasons for the decline are manifold," she tells Treasury Today Asia. And while there have been debates about debt issues and BRI projects not working out, "The main driver of the decline [in

Chinese lending] has been the domestic economy," she says. Domestically, there has been regulatory pressure on financial institutions to rein in their lending. As a consequence, lending overseas has also dropped, she explains.

When compared to other countries, the scale of China's international lending programme is massive. Scott Morris, Director of the US Development Policy Initiative, Co-Director of Sustainable Finance, and Senior Fellow at the Center for Global Development, explains that official sources – such as World Bank data – show that China is now by far the biggest lender in the world, government lender in the world, and is bigger than all of the major lenders of the Paris Club (which includes the United States, United Kingdom and Japan) combined. However, "It is pretty clear that official estimates understate the scale of lending," says Morris.

This points to the issue of 'hidden' lending. Dr Bradley Parks, Executive Director at research and innovation lab AidData at the College of William and Mary, explains how there has been a major increase in hidden debt. This is based on the AidData report Banking on the Belt and Road – which looked at 13,427 Chinese development projects worth US$843bn across 165 countries – and highlights how debt levels and implementation problems are affecting the BRI.

Matthew Mingey and Agatha Kratz, Senior Analyst and Associate Director respectively at research firm Rhodium Group, also point out that the overseas lending is much larger than previously thought. For example, the Boston University data doesn't include lending from commercial banks, which has increased. And it is other entities – not governments – that are increasingly the recipients of the loans, such as state-owned enterprises or investment vehicles.

Parks at AidData describes this as a trend of falling sovereign debt and the rise of hidden debt. He estimates that 70% of China's overseas lending is not to governments. And because these loans are to other entities, they do not appear on the government's balance sheet even though there may be an implicit – or even explicit – understanding that the government would have to step in if the project runs into difficulty.

Parks says that 42% of countries have levels of public debt exposure that is more than 10% of their GDP. "These unreported debts are worth approximately US$385bn and the hidden debt problem is getting worse over time," Parks says. He adds that governments of borrowing countries may not know the value of the debts they may or may not have to service in the future.

Another element of the 'hidden' debt problem, explains Morris, is that debtors are supposed to report their obligations, but many are just not good at reporting, or they may prefer to keep their borrowing hidden.

Even with lending that isn't included in official figures, there has still been a decline, especially during the pandemic. Morris comments this is part of a broader trend of China overlending in the past and now there has been a correction.

Mingey and Kratz at Rhodium Group argue that Chinese creditors have been rethinking their lending after they have run into problems with some of their projects. Borrowers have needed to renegotiate their loans, and according to the Rhodium Group researchers, up to a quarter of lending has run into trouble.

AidData research also highlights problems with the BRI projects and found that 35% had experienced problems with implementation, including corruption scandals, labour violations, environmental hazards and public protests.

Amid this, some projects are falling by the wayside. Brooke Russell, an Associate Director at AidData and co-author of the Banking on Belt and Road report said, "Host country policymakers are mothballing high-profile BRI projects because of corruption and overpricing concerns, as well as major changes in public sentiment that make it difficult to maintain close relations with China. It remains to be seen if 'buyer's remorse' among BRI participant countries will undermine the long-run sustainability of China's global infrastructure initiative, but clearly Beijing needs to address the concerns of host countries in order to sustain support for the BRI."

Chen at ODI notes that loan repayment issues have become more prominent in the last five to seven years. This comes in the context of accusations of 'debt trap diplomacy' and predatory lending by China, which Chen doesn't agree with. "I would push back against the 'predatory' narrative – that these Chinese banks are working to serve a grand strategic purpose of locking in African countries to become tributary states. I think that is very simplistic and it is not evidence based," she says. The idea of the 'debt trap', she adds, is a "myth that refuses to die".

With many of the cases, says Chen, the reality is a lot more complex. The port at Hambantota at Sri Lanka is often given as an example of China seizing assets. From the outside, she says, it looks like the government of Sri Lanka was in debt and the Chinese took it over. "This is the example that has been thrown around of 'this is what happens – China seizes your assets' – but that is not true," says Chen.

Academics Deborah Brautigam and Meg Rithmire wrote in The Atlantic that Chinese lending has been portrayed as the Mafia lending to a hapless gambler who is then in danger of losing a limb. They argue that Sri Lanka's debts were much larger than the Hambantota port deal, and the Chinese finance was not a cause of the country's financial distress. Also, there was never a default on the port and it was not an asset seizure. They write, "China's march outward, like its domestic development, is probing and experimental, a learning process marked by frequent adjustment. After the construction of the port in Hambantota, for example, Chinese firms and banks learned that strongmen fall and that they'd better have strategies for dealing with political risk. They're now developing these strategies, getting better at discerning business opportunities and withdrawing when they know they can't win. American leaders and thinkers from both sides of the aisle still give speeches about China's 'modern-day colonialism'."

Another case that has received widespread attention is the upgrade and expansion to the Entebbe International Airport in Uganda. This was also widely reported as an asset seizure, but the details are more complex. To address the various rumours and speculation, AidData published the actual loan contract between the government of Uganda and China Eximbank. AidData notes that the collateral is not actually the airport itself – an illiquid asset – but rather cash that is deposited in an escrow account. Also the agreement takes the unusual step, notes Parks, of stipulating that they have all revenues generated by the airport – even though this is a

public infrastructure that existed before the existence of this loan from China.

Uganda does have agency in this arrangement, however, and has demonstrated that it is possible to push back against stringent terms, notes Parks. For example, when it renegotiated, the government of Uganda pushed back against China Eximbank's demand that it has the right to approve spending decisions of the Civil Aviation Authority. When Uganda protested, China Eximbank scaled back its demands and agreed to monitoring the decisions instead.

Parks concludes that the Uganda case is not a debt trap. "Our analysis of the terms and conditions in the contract does not support the allegation that China engages in predatory lending. We instead find that Beijing is a shrewd negotiator who is willing to impose intrusive conditions upon sovereign borrowers to protect its balance sheet."

Despite the reports, the Chinese Embassy in Uganda denied that it would take over the airport. "Not a single project in Africa has ever been confiscated by China because of failing to pay Chinese loans," it said in a statement.

All this discussion of 'predatory' lending is perhaps unhelpful. Countries on the African continent are often being given too little credit to look out for their own interests, says Morris. Rather than using the term 'predatory', he prefers to look at the numbers and the behaviour. "Chinese lending is remarkably risk tolerant," says Morris and these institutions are lending in situations where the borrower is more vulnerable, and having a harder time servicing the loan, because of the scale of the borrowing from China.

On the question of whether they are victims in this lending, Morris comments that "China is willing to refinance and restructure terms." This is not necessarily a beneficent repayment plan as it can be structured so the creditor receives more money over time. You can go too far in saying that these refinancings are mutually agreeable and these borrower countries can look after themselves; the Chinese contract terms clearly favour the creditor, he adds.

In debt renegotiations, however, there are issues because of the secretive nature of some of the lending contracts. Parks comments, "by shielding their contractual arrangements from public scrutiny, Chinese state-owned banks have made it difficult for other lenders to know if they are positioning themselves at the front of the repayment line."

On the question of confidentiality, Chen at ODI says, "Debt transparency is definitely a problem for borrowers from China. A lot of these loans require you to take out an NDA [non-disclosure agreement]. Chinese banks do not behave like the World Bank or multilateral development banks; they behave more like commercial banks," Chen explains. In commercial lending it is advantageous to both the lender and the borrower for the rates not to be disclosed. This is typically not a problem, says Chen – it's only when the loan needs to be restructured that it is problematic.

Chen explains that the Covid pandemic caused a widespread shock to many countries and affected their ability to repay. "The problem with debt transparency is a bit of a live wire if you want to renegotiate with other creditors," says Chen, and no one has an interest in opening up their books.

From a legal perspective, says Chen, these contracts are default and commonplace, "They are not particularly unique or nefarious," she says. She also notes that if there is a legal requirement in a country that the loan has to be disclosed, this overrides any agreement that might be stated in the contract.

In terms of how the Chinese lenders operate, Chen and Kanyi Lui, an international finance lawyer, wrote a report on China's lending practices and found that, "Chinese lenders tend to give more weight to perceived long-term creditworthiness and the quality of the relationship with the borrower over technical contractual terms. Contractual terms should be evaluated within this broader relational context."

Chen says that in previous cases Chinese banks have been willing to defer the payment when borrowers ask to renegotiate, "In that sense Chinese banks are quite flexible," she says.

On the question of what happens to the debtors if they are unable to meet their obligations? "Chinese lenders are perfectly willing to kick the can down the road," says Morris. "Lending to support big complex infrastructure projects is not easy – you can't just flick a switch. It's not easy to walk away," says Morris.

This may be affecting more countries than previously thought. A paper by the Kiel Institute for the World Economy by Sebastian Horn, Carmen Reinhart, and Christoph Trebesch in January 2022, argues that defaults and missed payments are not usually disclosed. The research constructed a dataset of debt restructurings and found that problems – or 'credit events' – are "surprisingly frequent". The research notes that China's lending boom will likely result in a number of defaults or restructurings. The report notes, "If history is any guide, multi-year debt workouts and serial restructurings lie ahead." Also, a lack of transparency means that it is difficult to assess whether the lending will be sustainable.

There are lots of ways that the Chinese creditors seek to get repaid even if the country is defaulting on their debts, says Morris. "It is hard to pick up the project and carry it back to China," Morris jokes. "The Chinese are kind of stuck with the debtor" and that is why they have large escrow accounts in place. Those accounts may be held in Beijing with a commitment to revenue flows that may or may not be from the project itself, says Morris.

Chen argues that in reality it can be difficult to claim collateral that has been pledged. "We have not seen an asset seizure. In reality it is very difficult to claim it – even if the collateral is in an escrow account overseas," she says, adding that if money is drawn on that account, then they wouldn't get the rest of their money back.

This decline in lending, however, does not mean that China's ambitions for the Belt and Road have changed. "I do not think that the Belt and Road is over or finished," says Morris. "I think the sustainability of this overseas lending is very much part and parcel of China's investment scheme," he says, adding that is likely the government would step in if necessary to support the initiative. ■

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MMF reform: where next?

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

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

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

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

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

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

MMF reform in the US and Europe

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

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

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

Challenges today

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

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

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

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

Return of regulatory reform?

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

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

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

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

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

Impact of future changes

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

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

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

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

Investor voices

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

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

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

Stuart Fitzsimmons
Treasury Manager

WHITBREAD PLC

How does Whitbread use MMFs?

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

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

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

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

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

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

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

Is the prospect of further MMF regulation on your radar?

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

All together now

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

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

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

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

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

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

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

Suggested solutions included:

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

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

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

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

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

Case study

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Marcus Worsley, Group Treasurer, Apex Group

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

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

Treasury's remit should be defined clearly to understand which activities need to be assessed and how to structure the roles and responsibilities within the new treasury organisation.

Sander de Vries, Director of Treasury, Zanders

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

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

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

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

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

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

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

Focusing on interpersonal relationships

Steve Wong
Executive Director and Asia Treasurer

Steve Wong, Asia Treasurer at Adient, began his career when processes were manual and humans essential. Now, as a future with more artificial intelligence beckons, Wong explains why it's still important to build interpersonal relationships and stay one step ahead of the latest technology trends.

Adient (NYSE: ADNT) is a global leader in automotive seating. With approximately 75,000 employees in 33 countries, Adient operates 208 manufacturing/assembly plants worldwide. It produces and delivers automotive seating for all major original equipment manufacturers (OEMs). From complete seating systems to individual components, Adient's expertise spans every step of the automotive seat-making process. Its integrated, in-house skills allow it to take its products from research and design to engineering and manufacturing – and into more than 20 million vehicles every year.

Adient may be a company you've never heard of, but you have probably sat on something it makes. As a major automotive seating company, it supplies seats to most of the key auto companies in the world. It operates in an industry that is constantly changing and keeps one eye on the future and always has in mind what the car of tomorrow looks like. With its 'one-step ahead mindset', Adient is already working on autonomous vehicles, and soon you could be sitting on its seats in driverless cars.

In a world where artificial intelligence makes many human actions obsolete, Steve Wong, Executive Director and Asia Treasurer at Adient, believes it is important to keep building human relationships. He has done this throughout his career while he has witnessed the evolution of automation, artificial intelligence (AI) and machine learning. He has also adopted a one-step ahead mindset himself and has stayed curious so that he can stay on top of – and ahead of – the latest technology trends.

After graduating from university in the United States, Wong took a job in Hong Kong as a currency broker. This was back in the days of manual trading, where orders were shouted across a room, written down, and confirmed with a phone call. "That was how I started – it was all human," he comments. Then electronic booking systems came along, making the manual, and human, way of doing things a remnant of the past.

Was something lost with the move to electronic, non-human, methods? "Yes! Something has definitely been lost with the interpersonal relationships and the skills," Wong says. In that job, he explains, he learned to be accurate and work under pressure, and it was essential to maintain good relationships with people in order to do his job effectively. It also gave him a good memory and instinctive feel for numbers, which he continued to develop.

While Wong's role as it had existed became obsolete, he was already one step ahead and had his eye on educating himself further. He gained the Certified Public Accountant (CPA) and Chartered Financial Analyst (CFA) designations and embarked on a career working for a range of companies in corporate finance and treasury. He has worked for multinationals in various industries, all with different customer bases and ways of doing business. The companies he has worked for include paint and coating manufacturer PPG Industrial Coatings, clothing company Esprit, and musical instrument company Gibson, which is most well-known for its guitars.

Wong has had two stints at Johnson Controls, with the first from 2008 to 2013. He rejoined the company in 2016, albeit in a different form. At that time Johnson Controls was in the midst of spinning off its automotive seatings and interiors business, which at that time was known as Johnson Controls Automotive Experience. In January 2016, the company announced that it would be creating a separate publicly-traded company. And by October of the same year the transaction had been completed and Adient was created as a separate, independent company. The company is based in Michigan, United States, and is legally domiciled in Ireland.

The separation gave Adient the freedom to become a global automotive seating leader on its own terms, while also enabling Johnson Controls to focus on its core growth platforms around buildings and energy. At the time of the spin-off, the new name was explained: Adient is a Latin word that means accepting and advancing a situation or a stimulus, and represents the company's drive to engage, compete and always improve. The company has the vision of "improving the experience of a world in motion" and the company's CEO Doug Del Grosso has spoken publicly how he is focused on the company's principles of customers, quality, people, community and financial discipline. He elaborated further on the financial discipline by explaining that every person in the company should feel empowered and responsible for the performance of the company. And this means treating everyday decisions and spending as if it were the employees' own money.

> I think especially for the regional treasurer, the interpersonal relationship with the business is very important.

Wong echoes that view on financial discipline and says that money should be managed in a company just as if it is your own. And he also has an attitude that fits well with his company's ethos of advancing and improving. Throughout his career he has focused on staying curious, learning what is going on around him, and being ready to pounce when an opportunity has come his way. He comments that he finds the treasurer role interesting because he can solve various problems and bring changes that positively impact the company.

He has been keen to take on challenges as they have presented themselves. Recently he had the opportunity to fill in for the acting China finance lead when the position became vacant. This kind of decision wasn't made on a whim, however. Wong has been preparing himself, always learning and improving so that when opportunities come his way, he is ready to take them on – and perform well. "I think that it is good to prepare yourself and be ready. You have to earn trust so that the people you're working with know there is someone there who is ready to step up," says Wong. He adds that he hasn't just prepared himself by improving his treasury knowledge; throughout his career he has kept wider issues in mind and considered how he can contribute to the companies he works for.

Also, he explains, it's not just a case of putting your hand up and volunteering yourself when an opportunity comes your way; you have to be ready when the opportunity presents itself. "You have to prepare by not just doing your work, but also keeping your eyes and ears open. This should not just be focused on treasury, but you need to build business relationships with others internally and externally. Those interpersonal relationships are important for your career and taking on new challenges, especially in higher ranking positions of responsibility," Wong says.

In his role as Asia Treasurer, Wong now has plenty of responsibility. In Asia, Adient operates in nine countries and aside from his regular day job managing liquidity, cash, FX, banking partners and so on, he also has other duties. He is

based in Hong Kong, which is also where Adient's holding companies are incorporated for Asia investments, and he is appointed board chairman of the holding companies.

Also, Adient operates in Asia through wholly owned and partnerships, and Wong has been appointed supervisor or director of some of the company's joint ventures in the region. His role, he says, is interesting because of the changes the company has undergone and some of the major shareholder restructurings he has been involved with. For example, Adient announced in September 2021 that it was ending a joint venture with a partner in China, which freed it up to strategically transform its business in China and independently drive its strategy there.

All this has kept him busy and with so much on his plate does he like his job? "I like it very much," he says, without hesitation. "I get to do new things every day – that keeps me going and gets me up early," he says. He adds that he believes it is important to have curiosity and be passionate about what you're doing and feel engaged with your work.

He's humble, however, about his talents and downplays the skills that are necessary to manage such a large and varied workload. "This is not brain surgery," he jokes. He explains that understanding treasury, like other disciplines, is just about spending time on it and analysing what needs to be done. Like his treasury peers, one of his biggest challenges is dealing with the various restrictions across the Asian markets where Adient operates and ensuring he is able to effectively deploy the available liquidity to where it is needed. Another complication, he adds, is that in Asia – for example – he may be working with up to 15 currencies, which means he also needs to deal with multiple systems and regulations. In navigating all this he says, "The key is to keep learning and exploring what could be better and always improving the solution for the company."

He adds that everything in the role of treasury can be learned. "It's not rocket science; just spend time on it, we will figure it out. I learned that from a mentor – you just have to put your heart into it." And even in the case of rocket science, people like SpaceX's Founder and Chief Engineer Elon Musk have demonstrated that it is possible to learn anything, if the will and determination is there. "You have to put your heart into it and let people know that you are capable and want to contribute. Eventually people will know that they can work with you and do good things for the company," Wong says.

Wong points out that in a regional role – outside the company's headquarters – the treasurer does not typically have to deal with the capital markets, such as dealing with bond issuance, and so they have a different relationship with the business. In a regional role, the treasurer has to work harder to be more visible and demonstrate where they can add value. "I think especially for the regional treasurer, the interpersonal relationship with the business is very important."

Having good relationships has served Wong well while the company has worked through major balance sheet transformation by repaying approximately US$1.5bn debts in the last 12 months and adapted to a changing environment. He comments that one effect of the transformation is that we need to manage our cash and liquidity more closely. Although there is sufficient cash and liquidity, this new situation means that they have to manage the positions in a more focused way, all of which relies on effective communication and healthy working relationships.

The external environment has also become more challenging. There are a number of factors at play, including the crisis in Ukraine, a shortage of semiconductors for the auto industry, and other supply chain disruptions. This means the treasury team has to be prepared for any further disruption and ensure sufficient liquidity while also preparing effective mechanisms to deploy it effectively.

Commenting on the chip shortage and the supply chain disruption that the auto industry has experienced, Steve says that the demand for vehicles is there, but the supply side has been beset with logistical challenges including chip shortages. "Automakers could not produce and deliver on time," he notes. This in turn has impacted the sales of vehicles, and their various components – including seating – which in turn has an impact on the suppliers' cash flow. In this situation, says Wong, it is important to be ready, understand the options available and put a plan in place.

Wong – like many of his peers – has witnessed a number of advancements in treasury technology, which makes managing liquidity like this more efficient. Also, there have been other mega trends that have unfolded over the course of his career, such as the use of artificial intelligence. Back when he was a broker, he saw the move to automation and the removal of humans from many processes. A constant question that hangs over the use of AI is to what extent it will replace humans.

Will Wong's current role ever become obsolete? This is not something that he is concerned about. "That's too far ahead," he jokes. For now, he focuses on the task at hand: "I think that we need to be flexible, adjust ourselves and cope with the situation," he says. With technology such as AI, where people have been predicting the demise of humans for decades, it is possible to get carried away with the possibilities of how machines will outdo humans. "I think you have to keep in mind that you have got to be flexible and curious and learn every day. Some things could be replaced and some things could evolve – we'll just have to see…"

One area that could be improved for corporate treasury in the here and now, comments Wong, is making better forecasts. "I wish we could have these things done more automatically, more accurately, and have greater visibility of our cash position and cash flow. That would be helpful to every treasurer," says Wong.

With the introduction of electronic trading, it could be argued that the technology freed up people to do better quality, more value-added work, rather than the time-consuming manual way of doing things, like speaking on the phone and shouting across a room. Technology, however, can often remove the need for people to speak to each other, and this is where the human connection can be lost.

Wong is a great believer in the importance of the personal relationship. "Some things can be done more effectively and efficiently, and decision-making can be more accurate, but what can't be replaced is the interpersonal relationship," says Wong. "I think humans need to be flexible, adapt, adjust and grow." And, like the Adient mindset, they need to stay one step ahead of the latest technology trends. ■

The great technology rethink

While for some treasury departments technologies such as artificial intelligence and machine learning remain something of a mystery, the lockdowns and remote working that have resulted from the COVID-19 pandemic have forced a rethink of treasury technology platforms.

As the modern financial system has become increasingly complicated, treasury solutions have evolved accordingly to help teams manage FX risk, cross-border payments, inflation and reconciliations, says Ola Oyetayo, CEO at cross-border payments platform Verto. During the past 15 years, digital treasury solutions "have really beefed up and become pretty sophisticated", he adds.

"The adoption of innovative technologies within treasury is still at an early stage, the signs point to much broader adoption over the next three to five years as the relevance of these technologies to treasury becomes much clearer," says Himashi Soriano, Managing Director, APAC at the Association for Financial Professionals (AFP). "The move towards predictive and prescriptive analytics will elevate treasury performance and help mitigate several current risks, from forecasting to cybercrime. Modern technologies will certainly redefine what is possible."

Eric Aillet, Product Manager, Financial Messaging Marketplaces, Finastra, says there is a "clear appetite" for treasuries to switch to the latest technology, but the transition can be slow for a number of reasons. "As a cost centre, treasury needs to justify return on investment to trigger the related investment in technology," he says. "Additionally, not all treasury ecosystem players, including banks, software providers and internal systems are at the same level of readiness."

Another factor is risk – because treasuries are by their nature risk averse, many do not want to be first movers, but prefer to adopt proven solutions. This is a point also made by Singapore-based independent treasury consultant David Blair.

> For those companies who have the necessary core infrastructure in place and resolved the data veracity challenges, the focus is one of process automation, process/machine integration through application programming interfaces, and data analytics and insights through machine learning techniques.
>
> Stephen Randall, Global Head of Liquidity Management Services, Treasury and Trade Solutions, Citi

"Because treasuries tend to be risk averse, most do not rush into new technologies, preferring to be fast followers." Compared to other functions of a business, treasury "is in the middle of the pack" in its use of advanced technology.

Stephen Randall, Global Head of Liquidity Management Services, Treasury and Trade Solutions at Citi, says of treasuries' use of technology: "As you'd expect, there's a wide spectrum out there." Drawing on Citi Treasury Diagnostics' global benchmarking survey, he and colleague Duncan Cole, Principal, Client Advisory Group in the Treasury and Trade Solutions division of the bank, say there is good news and "not so good news" about the use of technology in treasuries.

The good news is that companies are continuing to deploy technology to advance treasury, with 68% of survey respondents having already deployed a treasury management system (TMS) or enterprise resource planning (ERP) treasury module. Almost two-thirds of respondents are looking at transformative opportunities across both their core business and treasury function.

"Less than half of respondents now report multiple e-banking platforms at each location, which indicates a shift to data transmission from banks, rather than reliance on accessing multiple bank portals," says Cole.

The not so good news is that many companies have "significant gaps" in deploying technology, with low levels of automation and connectivity. For example, only 63% of companies concentrate cash at a global or regional level, despite the availability of automated global pooling solutions from major banks. Nearly a quarter (23%) of companies have incomplete (less than 75% of total cash) daily visibility over cash positions. This is despite the fact that visibility and centralisation of cash and risk are a "core mantra for treasuries", say Randall and Cole.

Randall adds: "Straight through processing is key for timely decision-making and reducing the risk of fraud. However, 79% of companies have not fully integrated their TMS/ERP platforms with banks despite existing well-established standards. This extends even within the firm: 64% of companies report that their TMS is not integrated or only partially integrated with their ERP."

Another shortcoming is cash forecasting inaccuracy – a "key pain point for liquidity planning" says Randall. Of those surveyed, 80% were reliant on spreadsheets within their technology stack for forecasting. "While it is true that more than half of companies find their TMS technology does not support cash forecasting, today, fintechs and banks (sometimes in partnership) provide viable solutions."

The issue with technology gaps, says Randall, is that they "create cracks in the foundations of treasury management. That is never a good place to be but that can get glossed over when times are good, liquidity is plentiful, and risk is muted. But all comes home to roost when there is a crisis."

Blair also sees gaps in treasuries' technology deployments, saying the pandemic forced treasuries to digitise in order to cope with remote working. "This has revealed technology gaps and opened interest in the cloud. In this sense, Covid has pushed treasuries to evolve their technology platforms."

Soriano says the pandemic accelerated the need for a more agile, secure and scalable IT infrastructure at treasuries. "The forces of digital disruption are now driving change and it is really a case of 'when' and not 'if' a company will embrace treasury technologies. With change and uncertainty becoming the new normal, the need for operational agility cannot be underestimated. It is critical for survival that companies remain both relevant and competitive in these constantly evolving times."

Oyetayo says treasury teams that relied heavily on legacy software, standalone Excel spreadsheets and working in-person during the pandemic, began to see great urgency in switching to alternative digital ways. "Once the adopters of digital treasury technologies feel the benefits and efficiency of such software, they will be more 'sticky' and continue to use them for a long period of time," he says.

The pandemic instilled much creativity in treasury departments, says Enrico Camerinelli, Strategic Advisor at consultancy Aite-Novarica Group. This creativity included the exchange of digital documents with electronic signatures and systems that enabled treasuries to keep transactions going in the absence of "total electronic facilities" such as for invoices or payments. "A lot of attention was paid to the treasury departments' technology strategies, mostly devoted to moving from manual and paperwork into digital exchange of documents and transactions."

Of the technologies treasuries are pursuing as they rethink their strategies, cloud is a standout.

"AFP research shows corporate treasurers view the advance of cloud computing as the most important technological developments over the next three to five years," says Soriano. "Cloud-based solutions are becoming the technology deployment model of choice, given the advantages like accelerated implementation, lower costs, and greater agility."

Treasuries are becoming more open to cloud, says Blair as COVID-19 has driven remote working and the resultant need to connect and work from "anywhere".

Citi's survey found a broad interest in "all things digital" in treasury and finance, says Cole. This includes the utilisation of emerging technologies for process automation and data-led insights. "Driving both efficiency within treasury and

augmenting decision making are now the top two expectations for investing in emerging technologies," he says.

However, cost and integration of emerging technologies within established environments remain the top two hurdles that need to be overcome for transformational change to take place. Depending on the level of treasury sophistication, appetite/ambition, previous investment in technologies and level of proficiency in data management, a range of proven and emerging technologies are now being deployed, says Randall.

Banks like Citi are helping companies to improve their treasury management capabilities and processes through innovations such as real-time multi banking for cash concentration and real-time liquidity sharing. Such technologies enable treasuries to optimise working capital by facilitating liquidity mobilisation between surplus and deficit accounts in real time.

"For those companies who have the necessary core infrastructure in place and resolved the data veracity challenges, the focus is one of process automation, process/machine integration through application programming interfaces, and data analytics and insights through machine learning techniques," says Randall.

Three quarters of Citi's survey respondents indicated that data analytics and insights were the biggest area of opportunity yet only 34% of them are pursuing this area within treasury. This may be due to the infrastructural and data challenges most companies experience today, says Cole.

Oyetayo also cites data analytics as an area of focus. "Analytics, automation and data processing significantly reduce the amount of effort and time needed to manage liquidity, reconciliations and cash flows. The application of machine learning and data science will be most beneficial to creating cash and liquidity forecasts, helping teams anticipate problems and consequently plan ahead."

He believes that as they rethink their technology strategies, treasuries will be most focused on data processing related to spreadsheet software like Excel, as managing different sets of financial data is "a core part of a treasury's jobs". This process involves collecting data, cleaning data, uploading and processing it.

"Since it was first invented and adopted, data processing has helped mundane, data-entry jobs become more efficient," says Oyetayo. "Over the decades, spreadsheets software has evolved to make entering, cleaning and processing data much more efficient. With data science tools such as SQL and Python coming into play, it will become even easier and quicker to process big data sets. These tools allow teams to generate high quality data to be inputted into other treasury solutions, such as a reconciliation software, easily."

Finastra's Aillet says there are several areas where corporate treasuries are looking to adopt new technologies, including:

- Improving business operations through increased digitalisation, predictability and automation.
- Enhancing transaction security, for example, by using AI to scan payments and detect fraud.
- Streamlining the IT landscape to reduce costs and benefit from better integration.
- Reducing traditional bank fees by adopting fintech solutions.

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>
> Himashi Soriano, Managing Director, APAC at the Association for Financial Professionals (AFP)

There are two main areas of the treasury organisation that receive much attention in regard to automation, he adds. "Transaction processing has been an area of focus since 2000 and a lot of solutions are available, including for back office processing, cash concentration, accounting postings and reconciliation. The other area is decision making, where new technologies are bringing another dimension to this area and enabling processes to be automated."

In decision making, AI and robotic process automation are being used to ensure high quality data is available that can be used as the basis for hedging, delivering greater predictability to treasuries. APIs and RPA are being used to automate and link information across systems, including dealing platforms, position-keeping systems such as TMS, as well as systems for matching and for payment execution. Finally, fintechs and other new players are bringing greater efficiency by digitalising financial services using technologies such as blockchain and distributed ledgers.

"Each treasury is unique in terms of the setup of its banking ecosystem, IT landscape and its appetite to adopt new technology and change the way it operates," says Aillet. "Each also has a different risk threshold – knowing that the consequences of anything going wrong could be significant for the business. Treasury systems providers need to make it easy for treasuries to adopt new technologies while also supporting integration across the rest of the internal ecosystem so that ERP systems are aligned as well."

Blair says treasuries should work holistically to identify their biggest challenges in terms of wasted time and heightened risk (which are also great opportunities for improvement), and then find practical solutions. "These solutions may not (and generally do not) require bleeding edge technology. This pragmatic approach will generate the most value add. These challenges vary across industries, business models, and corporate cultures."

Camerinelli says many treasury departments still have a fight on their hands getting the budget for technology. "Another problem is that many times when I speak to treasurers, they tell me that they have an abundance of offerings, but sometimes what they are offered from fintech vendors are over-engineered or much more than what they need. Technology transition is difficult for treasurers because it is not easy to compare different solutions if you don't have the specific skill sets required." ■

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

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

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

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

Elsewhere, the circular economy offers compelling new growth opportunities and a strategy for reducing Scope 3 emissions, without which companies will never fulfil their net zero pledges. According to research from the **Ellen MacArthur Foundation in "Financing the Circular Economy"** if a circular approach were adopted in just five sectors (steel, aluminium, cement, plastic and food), annual GHG emissions would fall by 9.3 billion tonnes of CO2e in 2050, equivalent to the reduction that could be achieved by eliminating all transport emissions globally. As global trends around digitalisation, resource scarcity and supply chain upheaval gather pace, treasury teams are increasingly mindful of the circular economy's impact on cash flows and the future business environment.

Green issuance

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

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

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

Scope 3

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

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

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

Leasing and subscription

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

Challenges

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

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

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

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

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

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

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

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

Tech crackdown exposes divisions in China

China's regulatory crackdowns on technology companies have caused uncertainty for the sector, as well as investors. There are a number of factors at play, all of which highlight different schools of thought in China about the way forward for companies wanting to raise capital overseas.

China's regulatory action against a number of technology companies has cast a cloud of uncertainty over the sector, and each individually can be viewed as a microcosm of broader concerns in China. They also shine a light on a debate in China about whether Chinese companies' expansion should ultimately be encouraged or restricted.

A series of events have been painted broadly as the 'tech crackdown' in China. The most visible began in October 2020 with Jack Ma, the Co-Founder of Alibaba Group, being publicly critical of China's regulators. He was then summoned to a meeting and soon disappeared from public view. The next month, the initial public offering (IPO) of Ant Group – the financial affiliate of Alibaba – was suspended. Then there was the June 2021 listing of ride-hailing app Didi Chuxing in New York, which was greeted with enthusiasm by investors. But just days later, cybersecurity regulators in China took action against the company, causing its share value to plummet, and prompting the company to prepare a delisting from the United States.

This also comes against the backdrop of a long-running accounting dispute about US auditors gaining access to the working papers of Chinese companies that are listed on US exchanges. And on a domestic level in China, there has also been a focus on 'common prosperity' and addressing the wealth gap in China. This has all created uncertainty for Chinese technology companies, and in March internet analysts at J.P. Morgan China described the sector as "uninvestable" for the next six to 12 months.

There has been a "regulatory whirlwind", comments Kendra Schaefer, Partner – Tech at Policy Research company Trivium China. She adds that it has caused great uncertainty: "It has given investors whiplash, and no one knows which way to jump," says Schaefer.

Schaefer explains that a number of things have been happening in parallel. "Five or six regulators at the same time were pursuing their own agendas – they got a tacit green light from Beijing to rein in abuses of power by tech companies. They went after them at the same time for different reasons," she says.

This includes the State Administration for Market Regulation taking action against e-commerce platforms Alibaba and Meituan for anti-competitive practices. There has also been a crackdown on the online education sector. And there have been data and privacy issues at play, which came to a head just after Didi listed in the United States.

The Cyberspace Administration of China (CAC) wanted Didi to undergo a cybersecurity assessment before its overseas listing, and Schaefer points to reports that Didi was advised to hold off on its IPO. It is possible, she notes, that because the CAC has not previously been involved in listings, Didi may have interpreted this as a suggestion – rather than an order – because it had not previously been in their purview.

Nan Li, Associate Professor in the Department of Finance at Antai College of Economics and Management, Shanghai Jiao Tong University, notes that companies like Didi have been collecting vast amounts of data. "They are collecting data on where people are going and some of the locations are actually sensitive," says Li. This data includes maps and locations that could be issues of national security, and there are concerns about who will be able to access this data if the tech companies expand overseas. "There is some data that is necessary for them to keep and to use, but [the regulators] are still revising how to regulate the data usage for those platforms," says Li.

Also, notes Professor Li, there are issues about how data is used by any platform company – especially if it is being used for financial services – and the potential for misuse and information asymmetry between the tech giant and the user. She adds that these are not issues that are unique to China – all countries are considering how such companies and their handling of data should be regulated.

Regulation has been an issue with large tech companies, particularly those involved in financial services. While the

suspension of Ant Group's IPO is often viewed as punishment for Jack Ma's outspoken comments, there are justifiable reasons for the regulator to take action against platform companies like Ant Group and Tencent. Li tells Treasury Today Asia, "They all need better market regulation and appropriate regulation of how they should do financial services on the platform. This is very important – it is necessary regulation of fintech companies and why it was correct to stop the IPO [of Ant Group]," says Li. Ant Group, she comments is "a financial institution under the cloak of a technology company." She has previously written for SupChina that Ant was involved in deceptive branding, conflicts of interest and predatory lending behaviour that made it necessary for the state to intervene. In this context, the crackdown is not only understandable, but also necessary in order to develop a healthy platform economy and financial system, she argues.

Another major issue that affects overseas listings is the introduction of the US Holding Foreign Companies Accountable Act, which was passed in 2020, and stipulates that foreign companies that are listed on US exchanges must make their audit papers available for inspection. If they don't, they face delisting, and the US Securities and Exchange Commission has already publicly mentioned which Chinese stocks are at risk. "The clock is ticking," says Schaefer for those companies. In the past, this audit paper spat may have been viewed as an "ineffectual stand-off", but now things are really happening because of that act, says Schaefer. "The real thing to watch is whether or not China ultimately decides to open its books up," she adds. There have been reports and rumours that progress is being made on the working papers issue, but this still needs to play out.

These are just some of the issues that affect the technology companies that are listed overseas. "There are many streams running in parallel," says Andrew Collier, Founder and Managing Director of Orient Capital Research. He is also the author of China's Technology War: Why Beijing Took Down its Tech Giants and describes some of the overarching themes. One is the regulatory catchup that Beijing has had to do in regulating its tech companies. And another major theme, says Collier, is 'common prosperity'.

Common prosperity is not a new term, but there has been an increase in its usage which has been more noticeable since the tech crackdown. President Xi Jinping officially spelled out his vision for it in 2021, and Collier explains that this provides the context for understanding Xi's view of how the Chinese state should progress.

Common prosperity is about equality and addressing the wealth gap, and the technology giants are part of it because they are viewed as having amassed too much money and power. One view is that China is returning to the days of the Cultural Revolution and will grab the wealth of the rich; that Alibaba's Jack Ma got too big for his boots and needed to be brought in line. That, says Professor Li, is a misunderstanding and will not happen. The regulation of the sector and common prosperity, she says, does not mean the state views the technology companies and their founders as having too much money. "The view that this is like the old days of grabbing the wealth of the rich people and distributing it – this is a common misconception. It is a misalignment of all the information," says Professor Li. She argues that each of the issues affecting the technology companies – the various types of regulatory action – should be viewed independently and not conflated with each other.

Li describes common prosperity as the goal of creating an environment where hard work is rewarded, and also encouraging micro loans and credit to entrepreneurs to enable them to start their own businesses. Introducing these reforms is not an easy job, says Li. Since the 1970s, she notes, China has been transforming itself from a planned economy to a market-based economy. "It's not an easy job for China; it's not easy for any country," she says. "I still feel confident about the outlook of China. We are definitely not going back to the Cultural Revolution period. Outsiders think they are going to grab and remove the wealth of the rich," says Li. "That is not going to happen," she says.

In addressing all this for the tech sector, there is a big internal debate going on in China right now, says Schaefer. She describes the two camps as the 'doves' and the 'hawks'. The working paper issue highlights it: the first group is the economists who want foreign trade and want to reach a compromise so that companies can pursue overseas listings. And then there is the other group – the hawks – who see this as a national security issue, that you cannot show these working papers because they contain sensitive data.

This ties in with what Collier says about there being two schools of thought in China at the moment. "The Chinese leadership is torn between those who want to encourage more foreign capital and reform of the financial system, and then those who are concerned about raising capital outside of China," says Collier.

There is one view that foreign capital is helpful and China needs to be modernised further, says Collier. Then there is the other view that overseas listings would allow the United States access to troves of data – whether that is in the form of data on the journeys of Didi, or the contents of the audit papers.

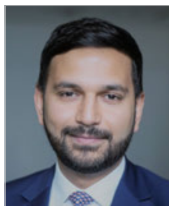
These issues affect a large number of stocks. "There is a lot of uncertainty," says Collier, and ultimately many companies may have to delist from exchanges abroad. Hong Kong could potentially be the listing location of choice for those companies that are more sensitive and are facing data restrictions, says Collier.

Schaefer agrees and says, "Some Chinese companies are already starting to think about pursuing a secondary listing in Hong Kong" so they can fall back on that if the worst comes to the worst. Hong Kong is attractive, says Schaefer, for such companies. And for the data heavy companies, Hong Kong may not be considered 'abroad' and so they may not need the cybersecurity review that the regulator is insisting on for overseas listings. Does Hong Kong count as abroad for Chinese companies? This is where things get fuzzy, and despite the issuance of some guidelines, Schaefer says this has muddied the waters further. Ultimately, if the regulator decides the company needs one, they have to have one.

While these issues play out, it boils down to two approaches: those who want to make things easier for technology companies and help them go abroad and raise capital, and those who remain concerned about data security and national security issues. Until it is clear which side of the debate the technology companies' fate will land on, uncertainty will remain for the companies – and investors. ■

Payments/ISO 20022/SWIFT

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



Nasir Ahmed
ISO 20022 Programme Lead
SWIFT

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

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

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

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

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

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

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

James Kelly
Group Treasurer
Pearson

Why ISO 20022 could be a game changer

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

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

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

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

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

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

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

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

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

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

Rijuta Jain
VP, Product Management, Payments
FIS

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

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

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

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

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

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

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

Next question:

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

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

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