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May/June 2024

Learning to live with Brexit

Eight years after Brexit, treasury teams voice frustration and cost around trade and payments. But also sound a positive note on new markets and bank relationships.

The Corporate View

Patrick McCartan

Vice President and Treasurer

Caterpillar Inc.

Treasury in the boardroom

Which treasury topics find their way into boardrooms, and how can treasurers communicate effectively with the board?

Investing

Treasurers gravitate towards liquid investment instruments

Risk Management

Derivatives demystified

Technology

Funding woes hit payments

Trade

The evolution transforming trade finance

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Risk and resilience

Treasury Today goes to press as geopolitical risk spikes even higher following the escalation of the conflict in the Middle East. It is at times like this, as ground war continues to rage in Europe, that cooperation and pulling together to protect our common interests becomes more important than ever. Against this backdrop, this edition's exploration of the impact of Brexit and the UK's decision to break away from the EU eight years ago, is thought provoking.

We find treasury teams still face enduring frustrations and costs around trade and payments. But new trading opportunities are becoming more apparent for UK corporates; bank relationships and their product offerings have been largely unaffected, and interviewees say Brexit has fostered a resilience that could serve companies well in an increasingly fragmented global trade dynamic.

Our investment feature explores how higher interest rates and treasury demand for low-risk investment is driving money into MMFs. According to data from global funds network Calastone, MMFs absorbed a record £4.38bn of capital last year, more than in the previous eight years combined. The treasury team at shoemaker Dr. Martens explain why a combination of MMFs and overnight/term deposits to manage short-term cash works well.

Continuing our focus on risk in today's increasingly uncertain world, we explore how treasury teams use derivatives to hedge and better manage their exposure. George Dessing, Executive Vice President, Treasury & Risk at Wolters Kluwer shares how the company's derivative strategy is rooted in simplicity, with the sole purpose of mitigating risk.

And at times of crisis, board level attention on treasury inevitably heightens. We explore which treasury activities find their way into company boardrooms, and how treasurers can communicate effectively with the board when the need arises.

Finally, we explore progress in digitising trade finance which despite technological leaps in other areas of treasury, remains stubbornly rooted in paper processes. Still, ABB Limited, the corporate treasury arm of Switzerland's industrial conglomerate ABB Group, has digitised its export trade processes following a technological overhaul. Proof that change is slowly coming and that evolution – not revolution – will gradually end manual processes for lasting progress.

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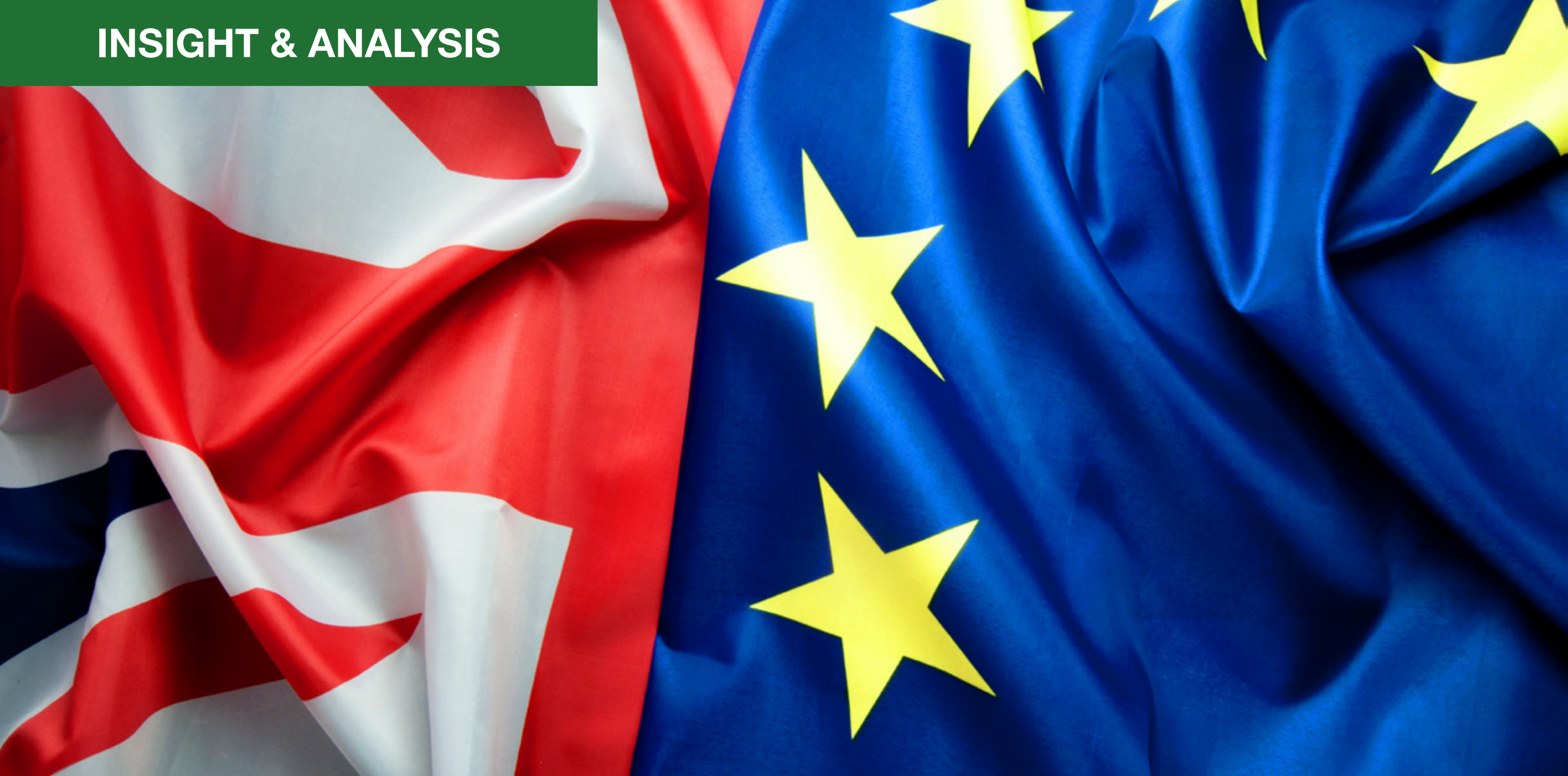

Learning to live with Brexit

Eight years on since the UK voted to leave the EU, and treasury teams still face enduring frustrations and costs around trade and payments. But new trading opportunities are becoming more apparent; bank relationships and their product offerings have continued smoothly and Brexit has fostered a resilience that could serve them well in an increasingly fragmented global trade dynamic.

So much has happened since June 2016 when the UK voted to leave the European Union, it's difficult to unpick what is and isn't a consequence of Brexit. Notwithstanding it's multi-stage implementation, extrapolating the Brexit impact from the pandemic, war in Europe and supply chain disruption, is challenging.

Still, eight years on and Treasury Today interviewees link a handful of key challenges to Brexit – namely enduring frustrations and costs around trade and payments and challenges recruiting. But they also say Brexit has fostered a resilience that serves them well in today's new geopolitical landscape and that they've learnt to live with Brexit; they talk about it less, and its significance on corporate treasury has waned.

Bureaucracy and costs

There is no doubt Brexit has added to bureaucracy and costs. Like new customs rules and declarations that businesses must fill in which take time and resources and slow down trading operations. UK companies pay more duty on EU imports if they don't qualify as tariff free trade under the EU-UK Trade and Cooperation Agreement (TCA) because they don't fulfil rules of origin requirements. Up and coming SPS import checks on animal and plant imports from the EU will create another bottleneck.

Another challenge for UK corporates manifests in changes to the labour market. The end of freedom of movement means foreign workers require work permits creating an administrative burden for business – from whom calls for a relaxation of short-term business visa rules is growing louder. "There is a time and cost dimension for businesses getting the right talent in place at the right time," says James Caldecourt, Head of International Trade at Deloitte.

Payment headaches

Elsewhere, Brexit has added to bureaucracy and costs around payments. Corporates that have online or point-of-sale (PoS) offerings – both UK companies that previously transacted with an EEA acquirer or Pan-European clients with a presence in both the UK and EEA – face extra costs and bureaucracy. For example, the latter now requires two separate acquirers instead of one, which could mean double the reconciliations needed from an added set of settlements, explains Sara Castelhano, Managing Director, Co-head of Payments & Commerce Solutions for EMEA, J.P. Morgan.

"Cross-border payments between the UK and EEA countries can no longer be defined as intra-EEA payments under PSD2," she continues. "This implies that the principal on wire payments can no longer be protected from deductions, and therefore incur cross-border transaction fees. With that,

we have seen fees increase in this space, which is another driver for corporates to locate their European entities in Europe," she says, referencing another consequence of Brexit – a trend amongst large corporates to shift the location of their treasury centres and in-house banks from the UK to Europe to better support their businesses. "If a corporate had an Irish entity with a treasury structure in the UK, that has now shifted to Ireland."

IBAN discrimination and additional data requirements under the EU's Funds Transfer Regulation (FTR) is also impacting payment processes. "Post-Brexit, we continue to see scenarios where companies won't accept SEPA payments and direct debits initiated from 'GB' IBANs. This holds particularly true in the case of tax payments where localisation of the accounts in-country (with an EU IBAN) is considered a must have despite the reachability that the SEPA zone offers."

She adds that to ensure FTR compliance, businesses must supply additional data requirements to fulfil a payment journey between the UK and EU, adding to operational considerations for corporates when they onboard new customers.

Trade flows

Brexit is reshaping trading activity as firms change their business models and diversify to markets outside the EU. A trend captured in a recent Deloitte survey of 750 international UK firms, which found three quarters of businesses that had lost EU trade had experienced compensating gains with countries outside EU leading to an uptick of sentiment.

"It's interesting how quickly some companies can shift their focus to outside Europe. Our recent survey data has shown that some businesses are starting to experience gains in non-EU markets and that business sentiment towards Brexit is starting to improve," says Caldecourt.

One factor feeding into that optimism is new Free Trade Agreements. So far, the UK has only negotiated new FTAs with Australia and New Zealand with "limited opportunity." But optimism is growing regarding opportunities inherent in CPTPP with 11 countries in the Pacific Rim. This agreement will come into force later this year in a staggered introduction that promises deeper access to markets like Malaysia. "The GDP boost will be small but the impact in niche areas could be significant. The CPTPP will become more effective as other countries join like Thailand," he predicts.

New FTAs with India and the GCC offer potentially bigger wins. "India is in the late stages of a negotiation that is more focused on goods than services. It might not be tariff free but given the size of the market it could be a significant opportunity," Caldecourt continues.

Elsewhere, the UK has written new bilateral agreements into UK law with countries like Vietnam, replacing previous agreements with Brussels. The legal framework has been transitioned across and companies have carried on without foreseeable changes. Next up, the UK will re-negotiate existing trade agreements with countries including Switzerland and Mexico, South Korea and Turkey.

Sentiment might be picking up amongst large corporates but for **smaller business**, the impact of Brexit on their ability to trade with Europe remains a key concern. Repeated confidence surveys from the Federation of Small Businesses finds SMEs are experiencing reduced export values and struggling to export to their biggest market.

"Europe remains the largest export market for SMEs. Only 5-6% of respondents said they are looking at new markets such as the US and Middle East," explains Kate Foster, Head of International Affairs at the FSB. "The costs of trading in Europe is disproportionate for a small business compared to a large company, particularly because their exports are low volumes." Still, she does link pockets of SME optimism to Brexit – like new SME clusters developing around innovative technology linked to smart borders in North Ireland. "Northern Ireland is in a unique position to accelerate the adoption of this kind of tech," she says.

The view from Europe

Talk to a large European company, and the impact of Brexit is a distant memory. For the treasury team at a German multinational, their biggest concern at the time was losing access to financial products and a choice of counterparties amongst their banking partners. This manifests particularly around concerns about their derivative exposure with UK and US banks acting out of London if neither party could agree on the recognition of each other's derivatives trading venues under an equivalence regime.

Once these banks opened subsidiaries in cities like Frankfurt, Paris and Amsterdam corporates could write new ISDA contracts underpinning their derivative exposure. New bank subsidiaries initially carried counterparty risk because many had lower credit limits, but once banks started "pushing billions" into their subsidiaries, this soon changed.

"Creditworthiness was an issue," recalls a member of the treasury team at the German multinational. "But today these subsidiaries have the same capital backstop as they had when operating out of the UK. We don't trade with London-based banks anymore because all our banks have subsidiaries in Europe and offer the same products. Honestly, no one talks about Brexit."

Their comments touch on another enduring consequence of Brexit. Today, UK corporates continue to use either UK or European banks for every kind of product or service because of the UK's approach to open borders. European businesses, on the other hand, are now primarily serviced by European institutions. European banks with large branches in London are under increasing pressure from EU authorities to bring significant amounts of their business back to Europe.

EU pressure on the bloc's banks is evident in new laws around interest rate derivatives, for example. Witness how Nasdaq Europe is set to expand derivatives clearing to include euro interest rate swaps, used by companies to hedge against adverse moves in borrowing costs. A new EU law will force European banks to have an "active account" at EU-based clearers for euro denominated interest rate swap transactions, reducing their reliance on the London Stock Exchange and enabling EU regulators oversight of these transactions.

Commentators don't necessarily believe that new bank subsidiaries set up in Europe after Brexit will grow bigger still or suck more business out of London. They notice some banks are growing their desks, but this is countered by concerns around the ability to tap – and easily let go of –

> Europe remains the largest export market for SMEs. Only 5-6% of respondents said they are looking at new markets such as the US and Middle East.
>
> Kate Foster, Head of International Affairs, FSB

talent in European cities, plus questions around the depth of the wider ecosystem needed to support banks outside London. "Sure, London has lost business, but the City still exists; employs thousands of people and financial services are growing in London," says Jonathan Herbst, Global Head of Financial Services at Norton Rose Fulbright.

Again, it is difficult to directly link the blossoming of London's fintech and non-traditional finance sector to the post-Brexit shake-up in banking. But in another positive note, Lisa Dukes, Treasurer and Co-Founder of risk management specialist Dukes & King, believes the spike in innovation amongst financial services in recent years is a consequence of London's diversification.

The city has emerged as a crypto and non-traditional finance centre and a myriad of fintech's selling everything from TMS to hedging instruments have sprung up. "The direct link to Brexit is questionable, but diversification has offered the UK opportunities to focus on innovative sectors and emerging growth areas, potentially bolstering its resilience in the face of uncertainty," she says.

Regulatory divergence?

Interviewees point to some examples of regulatory divergence. For example, the UK's payments landscape post Brexit has shifted to tangibly strengthen consumer protection, positioning the UK ahead of Europe.

Like Consumer Duty, which began to come into force in 2023 and sets higher and clearer standards of consumer protection across financial services and requires firms to put their customers' needs first. Elsewhere, the Payment Systems Regulator has introduced a new reimbursement requirement for Authorised Push Payment (APP) fraud within the Faster Payments system, notes Castelhano.

The requirement, which starts in October this year, will require payment firms to reimburse all in-scope customers who fall victim to APP fraud in most cases, and to provide additional protections for vulnerable customers. The UK's APP reimbursement requirement has a wider scope than those proposed in the EUs' draft PSR, which looks specifically at unauthorised transactions and bank employee impersonation, she says.

Still, commentators say they have yet to see significant regulatory divergence. The UK Financial Services and Markets Act 2023 which received Royal Assent in 2023 revokes EU-derived legislation relating to financial services and markets but did not generally repeal EU law embedded in UK primary legislation which has remained largely unchanged to date.

The UK's Future of Payments Review and the EUs' PSD3/PSR still broadly share common thematic goals of enhancing consumer protection and transparency, enhance and maximise open banking opportunities, improve regulatory oversight and alignment.

If the UK and EU's regulatory systems significantly decouple, financial services and corporates will feel the impact of Brexit more keenly. As the EU continues to pump out large amounts of new regulation the UK could potentially position itself as a more competitive destination over time where doing business is easier, in line with the promises written into the Edinburgh Reforms.

Still, Herbst argues that regulation will play a smaller role in creating a dynamic financial hub and attracting banks and corporates to London than other factors like housing, taxation, and most importantly skills – where London continues to have an advantage over European rivals. "Don't view legislation in isolation," he says.

Nurturing resilience

Brexit has fostered a new resilience and ability to cope with a changing world where free trade and open borders are no longer certainties. Treasury teams have had to move to navigate a transformed geopolitical landscape, prompting critical reassessments of supply chains, market positioning, and expansion strategies that will stand them in good stead for today's uncertain world. "Amidst rapidly evolving global trade dynamics and regulatory changes, adaptation becomes imperative for businesses seeking to thrive in the current era marked by market changing events," says Dukes.

She says that despite the many complexities of Brexit, one potential positive outcome is the shift towards a more self-sufficient approach. Companies have had to streamline operations, optimise resources, and venture into new markets to sustain growth in the rapidly evolving global landscape.

"By redirecting focus internally and forging partnerships with partners on a bilateral basis, the UK positions itself favourably in a world transitioning towards trade tariffs and domestic focus. This adaptability may prove crucial in navigating an increasingly fragmented global trade dynamic."

Norton Rose's Herbst concludes with his take on the last eight years. "Brexit was not something everyone welcomed, and a lot of work has gone into it. But we have all learnt to live with it." ■

TREASURY KEY TO MITIGATING BEPS IMPACT

Treasury teams must help their tax colleagues highlight required changes to financing arrangements and ensure that hedges are not compromised by new base erosion and profit shifting (BEPS) rules.

Pillar Two of the BEPS initiative introduces a global minimum effective tax rate where multinational groups with consolidated revenue over €750m are subject to a minimum rate of 15% on income arising in low tax jurisdictions.

Many experts have warned that complying with the rules is a more complicated process than it initially appeared – particularly in the US which already has two minimum tax regimes in the shape of the global intangible low-taxed income (GILTI) regime and the corporate alternative minimum tax (CAMT).

Critically, every jurisdiction in which a group has operations will need to be considered separately to assess if its effective tax rate falls under 15% and if so, a top-up tax will need to be calculated and paid for any such jurisdiction. Additionally, specified payments made to related parties may also become subject to new withholding taxes.

"The new rules require detailed calculations for each jurisdiction in which a multinational entity operates and include specific rules that will likely need input from treasury teams to provide additional data points to their tax teams regarding financial and hedging transactions," says Kash Javed, KPMG's Head of International Tax in the UK.

The tax rate applicable to intra-group financing arrangements may be impacted under the new rules and treasury teams will need to work with their tax teams to ensure the post-tax effectiveness of hedges is not impacted.

"Cash flow plans may need to factor in new top-up taxes becoming payable in particular countries," says Javed. "Treasury teams should ensure they closely liaise with their tax colleagues to ensure that the additional input needed is identified early and that tax team's input into new transactions is obtained."

In the past, jurisdictions have used low tax rates, tax holidays and various tax incentives to attract foreign direct investment explains Chad Hungerford, Partner at Deloitte Tax.

"Many of those levers will no longer be available following the enactment of Pillar Two," he says. "In the area of corporate treasury and corporate finance this may significantly change where and how companies hold, invest and circulate available funds."

Corporate treasury and inter-company financing have long relied on low or no tax structures to effectively redeploy excess funds within a group. Companies will have to reassess those structures post-Pillar Two as many may now result in significant tax costs.

"The transitional safe harbour (a short-term measure to exclude a group's operations in lower risk countries from the compliance obligation of preparing full Pillar Two calculations applied to years beginning no later than 31st December 2026) and Global Anti-Base Erosion or GloBE regimes have targeted anti-abuse measures aimed at limiting the ability of groups to use corporate finance to achieve tax advantages," says Hungerford.

"These rules are written broadly and may result in ordinary business transactions resulting in significant tax liability," he adds. "Pillar Two considerations must be baked into corporate treasury decisions going forward."

Regardless of whether or not the US implements BEPS, Jose Murillo – National Tax Department Co-Leader at EY – observes that widespread adoption by other jurisdictions has the potential to increase the corporate tax liability of in-scope US multinationals by as much as 18%.

"US multinational entities need to be modelling out the potential impacts, identifying actions they need to take, and engaging with US policymakers to explain how these rules will affect both their industry and operations," he says. ■

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Treasurers value money market fund certainty

Continued allocation to money market funds suggests that their appeal goes beyond representing a safe haven in times of economic volatility.

Despite a drop-off at the end of the year as increasingly confident investors shifted their focus to equity and fixed income funds, 2023 was a good year for money market funds (MMFs).

According to data from global funds network Calastone, a combination of high interest rates and low risk saw MMFs absorb a record £4.38bn of capital last year, more than in the previous eight years combined.

ECB data shows that total assets of euro area MMFs rose by 12.5% last year and analysis by fund flows and asset allocations data provider EPFR suggests global MMFs have continued to do well over the first three months of this year.

This view is supported by the actions of corporates such as Dr. Martens, which uses a combination of MMFs and overnight/term deposits with its approved banks to manage short-term cash and maintains a small buffer on key operating bank accounts.

"Our general aim is to minimise idle cash and by doing this we earn interest on our cash balances while maintaining a high level of liquidity," explains Mark Hirst, Group Treasurer. "Money market funds are a great way to diversify our cash across pre-selected, high quality pre-approved counterparties."

The company is very clear with key stakeholders in the business that this approach is never completely risk-free, but that they should typically think of these investments and the funds as very safe and stable.

"We favour low volatility funds," says Hirst. "These investments are short term in nature and we can withdraw or redeem our money on demand."

Performance is reviewed every month and reported via Dr. Martens' monthly treasury management information pack. "We keep a close eye on the credit quality of fund companies and their funds and every six months or so we invest time in researching new funds to understand if they meet our needs," adds Hirst.

MMFs also play a key role in American Honda's investment strategy. "Due to the nature of our operations and the liquidity role we play in the company, our portfolio is kept very liquid," explains Kim Kelly-Lippert, Manager of Treasury Operations. "As such, most of our cash is invested in bank deposits and money market funds. Money market funds provide us with easy access to liquidity as we have the option to redeem from the funds as often as needed."

The company is currently investing in government MMFs that due to the nature of the investments are high quality, carry a stable net asset value, and are very liquid. It also uses a wide variety of funds that give it the opportunity to diversify its portfolio per the requirements of its investment guidelines. Unlike the bank products, the funds are broadly diversified and American Honda is not subject to the individual credit exposure.

"For day-to-day management of the funds, we compare and review the metrics of each fund and make the decision on where to purchase or redeem," says Kelly-Lippert. "We trade through the ICD Portal, which is integrated through API to our treasury management system Kyriba and the upload is fast and easy which creates higher efficiency for trading funds. With the upload, all our trade tickets, positions and reporting are updated automatically."

The company also uses the information provided on the portal for data reporting and analytics, running reports and reviewing the detailed portfolio holdings information and fund metrics provided by each fund group.

"We take an even deeper dive each month into the portfolio holdings by using the reporting information from the portal, which combines money market fund holdings and direct holdings where we can look at our overall exposures and underlying credits," says Kelly-Lippert, who adds that the company is comfortable with its current allocation.

"With the choice of using government money market funds it is not really a credit issue, but more about rates, portfolio structure and relationships," she says.

Many corporate treasurers are taking a more critical look at their investments in the wake of last year's US regional banking crisis with an eye towards heavy concentrations with individual counterparties suggests Sebastian Ramos, EVP of ICD Portal.

"Much of the new issuance has been around D&I initiatives for corporations wanting to make a social impact while also earning a competitive return," he says.

According to Dan Farrell, Head of International Short Duration at Northern Trust Asset Management, treasurers are asking two key questions – how long central banks will keep rates at current levels before cutting, and what the pace of cuts will be when they start.

"Naturally, astute treasury teams are looking to maximise the short-term investment opportunities available to them while maintaining liquidity and security," he says. "In terms of product innovation, the journey toward longer maturities can extend beyond cash or money market products into the ultra-short strategies that can enhance investors' high quality, short duration exposure."

The main difference between bank deposits and MMFs can be seen when rates are falling. MMFs can purchase securities with longer maturities to stagger the effects of the rate reduction and by retaining higher yields over an extended period can provide more appealing returns than short term bank deposits.

Central banks have been gaining confidence that their tightening cycles are impacting inflation, but they require further information before they can declare victory. The last mile in getting inflation down to 2% is proving stickier than the market expected, leaving central bankers vindicated for erring on the side of caution.

"We continue to believe that the question central banks face is how long to remain restrictive rather than how restrictive they need to be," says Farrell. "Further information on inflation and wages is required before they will be comfortable commencing their cutting cycles, but they look most likely to begin at the end of Q2 for the Fed and ECB and start of Q3 for the Bank of England. The path beyond the first rate cut will continue to be data dependent, where central banks could approach the cutting cycle cautiously."

Kim Hochfeld, Head of Global Cash Business at State Street Global Advisors describes current treasurer appetite for MMFs as being at a level that would only expect to be seen once or twice in a career.

"To put that into context, an estimated US$1trn left bank deposits in the US alone in 2023 and went into money market funds," she says. "Global rate rises led these funds to outperform bank deposits while offering a more diversified credit exposure within an AAA-rated wrapper. It became a very practical, obvious choice for most treasurers to use a money market fund for excess liquidity."

Over the last 12 months a number of providers have introduced funds classified as Article 8 funds under the EU's Sustainable Finance Disclosure Regulation.

"At a high level, these funds also seek to invest the majority of the fund's capital into sustainable investments and apply negative screens to the portfolio so that they do not invest in issuers that violate certain international norms or are involved in certain business activities," says Hochfeld.

State Street Global Advisors has also seen investors increasingly likely to consider sterling and euro government funds. Until this point in the rate cycle there had been extremely low demand for these solutions but treasurers now have the choice of whether to dial up or dial down risk in their liquidity investments while still earning an attractive yield.

"With dollar excess cash sitting in a money market fund yielding as much as 5.5%, even traditionally riskier asset classes have struggled to attract flow," says Hochfeld. "It is a very low risk security to buy in the context of a volatile investing environment."

During previous interest rate cycles, money has stayed in MMFs until central banks stabilised rates and then gradually moved out as rates fell. There is an interesting nuance though in that money market funds tend to buy longer dated paper.

"As a result, they are generally able to offer more competitive yields than what banks are able to pay on their deposits in a falling rate environment," adds Hochfeld. "That means that money market funds tend to outperform bank deposits for a period, remaining competitive for longer."

The majority of the change within the sector has occurred within portfolios as holdings have shifted from significant repo allocations to US Treasury Bills says John Donohue, Head of Global Liquidity at J.P. Morgan Asset Management.

"We expect to continue to see consolidation in the tax-exempt sector," he adds. "On the digital/blockchain front we will continue to see managers experimenting with new technologies. However, those projects will take time and resources to gather more interest."

Donohue reckons improving macro outcomes likely means less cuts than the market is currently expecting. "A modestly declining or higher-for-longer rate environment should continue to keep money funds attractive in 2024 and beyond," he says. "Depending on where bank deposits are priced, we may continue to see money market funds taking market share from bank deposits for the foreseeable future."

MMF returns are determined by their very conservative investment decisions, as it is not the return on cash that is paramount but the return of cash. Therefore, returns will generally underperform those of funds that take more investment risk when market conditions are conducive.

The extent to which interest rate movements and market volatility impact MMFs in Q2 and beyond will depend on the severity of these rate movements and market volatility and how investors are positioned or react to them explains Kush Sondhi, Client Portfolio Manager at Invesco.

"As conservative and very short-dated duration funds invested in very high-quality securities, money market funds can manage interest rate events very well. Market volatility may have more of an impact on flows but these can be managed through a well-diversified and laddered maturity profile."

Alastair Sewell, Liquidity Investment Strategist at Aviva Investors refers to increased demand across currencies, noting that as of mid-March the average sterling low volatility net asset value MMF was yielding 5.35% gross, a premium over the interbank rate of 5.19%.

Reduced central bank rates will ultimately feed through to MMF yields, but Sewell says history shows there will be a lag. "Going back to 2014 there was roughly a one year lag between market rates turning negative and money market funds yields turning negative, largely due to funds' ability to 'term-out' their assets," he says.

According to Sewell, the innovation the market is waiting for is around tokenisation. "There is no reason why a tokenised commercial paper could not settle near-instantly, which would be a significant benefit to money market funds by reducing the time between trade instruction and delivery of trade proceeds," he concludes. "But while there have been some interesting early developments, broad adoption still seems a way off." ■

Treasury in the boardroom

Times of crisis tend to bring heightened board-level attention on treasury – and the last few years have brought more than their share of black swan events. So which treasury activities find their way into company boardrooms, and how can treasurers communicate effectively with the board when the need arises?

In recent years, the importance of the treasurer's role within the organisation has continued to grow. For example, the PwC 2023 Global Treasury Survey found that 24% of treasury functions consider themselves to be strategic partners, with 53% citing strategic thinking as a key competency for the treasurer of the future.

"In recent times, treasurers' roles have been well-recognised by the Executive and the Board, as treasurers provide vital strategic business and financial inputs, proactively manage liquidity and critical financial risks, including managing uncertainty, volatility, compliance, and stakeholders demands," observes Gopul Shah, Director, Corporate Treasury and Structured Trade Finance at Golden Agri-Resources (GAR), which is headquartered in Singapore. In many corporations, he notes, "treasurers' roles are also expanding to include risk management, insurance, structured finance and membership of the Executive Strategy and Risk Committee."

So to what extent are treasurers engaging with the highest level of leadership within their organisations? As Marianna Polykrati, Group Treasurer of Greek aquaculture company AVRAMAR, explains: "Collaboration between the board, executive management, and financial experts is essential to navigate complex financial landscapes and maintain the company's financial resilience and competitive edge."

According to Polykrati, the boardroom's involvement in treasury matters can be summarised in two key areas:

- **Treasury policies and procedures**. "Treasury policies are crafted to mitigate the financial risks and to maximise returns on investments," says Polykrati. "Board oversight ensures transparency and accountability in treasury operations, safeguarding shareholder interests."
- **Financial strategies, risk management and liquidity**. As Polykrati explains, "Board members deliberate on optimising cash flow, investments, and debt management to ensure the company's financial health and stability. They assess market conditions, interest rates, and regulatory compliance to make informed decisions."

But what this looks like in practice can vary significantly from company to company. "Most established companies have some form of delegated authority, whereby certain treasury matters are dealt with outside the boardroom," says David Stebbings, Head of Treasury Advisory at PwC. "There's a line of command whereby certain matters go up to the boardroom including the approval of policy, while others go to an audit committee or a finance committee. More routine aspects are delegated by the CFO to the treasurer."

Other matters which will be handled at the board level often include significant debt matters and financing exercises. In many cases, topics which are covered by a board-approved treasury policy don't need to be taken to the board, although treasurers will report regularly on compliance to the CFO and the audit committee.

"If you've got a FTSE 350 startup that's growing quickly, most treasury matters go to the board, because it's the only governance forum," says Stebbings. "In other cases, people make decisions without taking them to the board, because they're the owner of the business and there is really no board. There are many different models."

Heightened focus

During periods of heightened risk or market turbulence, however, the treasurer is more likely to be asked to present directly to the board. As Stebbings points out, it's a truism that treasurers often only need to go directly to the board if something has gone wrong, such as the loss of money due to a bank failure.

"During the LDI pensions turmoil in 2022, many businesses had to lend money to pension funds to meet short term margin requirements, meaning that the treasurer had to tell the board what was going on – either via the CFO, or with the CFO," he says. "Likewise, during the Covid crisis, treasury became high on a lot of board agendas owing to the effect on financial markets."

Anthony Buchanan, Group Treasurer of Asahi Europe & International, reports directly into the company's CFO, who also chairs the Risk Management Committee. Buchanan explains that treasury has had a strong link with the boardroom for many years, spanning Covid and working capital discussions, as well as commodity volatility and hedging. Looking further back, other events that have been discussed at the board level include the 2008 financial crisis and the 2012 euro credit crisis. As Buchanan remarks, "'Black swan' events are no longer something that happen once every ten years, but can now happen every two or three years."

Understanding exposures

Industry expert Jennifer Ceran agrees that the degree of interest in treasury at the board level tends to vary depending on the level of risk at a particular time. Ceran has a wealth of experience spanning treasury and finance: she has previously held a number of finance and treasury roles at eBay and PayPal, before becoming CFO of Smartsheet, a role that she

held until 2021. She is currently a board member for a number of technology firms.

"If a company is facing more risk in the form of large debt renewals, or is planning to invest large amounts of cash in the market, the board will want to really understand what's going on, and be there to help and support the company with those kinds of exposures," she comments.

During last year's banking turmoil around Silicon Valley Bank, for example, Ceran notes that many small and medium-sized companies were using SVB as their exclusive provider. "When that happens, the board obviously wants to understand the size of the exposure and the plan going forward to ensure that companies aren't reliant on just one bank."

In times of difficulty, boards also wanted frequent updates on what each company was doing to address that risk, Ceran adds. "First of all, it's about making sure the company is covered in terms of paying vendors and salaries. Secondly, they want to know where excess cash balances are being held, and whether they are all with one bank." While depositing $300m with a single bank used to be unremarkable, she notes that last year's bank failures underlined the risk of "putting all of your eggs in one basket".

But while board level attention on treasury can vary depending on market conditions, the profile of treasury within the organisation has broadly increased in recent years. "Since the 2008 financial crisis, there has been a transformation where you're seeing more focus on treasury at the board level, and more requests for having treasury present to the board," comments Ceran. "It's becoming an increasingly important area for boards to understand, so that the company is able to control its own destiny."

Building a tight relationship

In some cases, treasurers may play a proactive role in engaging with the board about the implications of market conditions. Looking back to the 2008 financial crisis, Ceran said she spent a lot of time presenting to the audit committee, and ensuring that the board understood how the company was affected by dramatic changes in the global financial markets.

"As Lehman Brothers was failing, we had exposure, we were taking action, we were very proactive – and that's what the board wanted to see," she says. "But if we hadn't been doing those things, there were very experienced C-suite executives who were there to give us good advice about what more we could be doing, and what we needed to watch out for. So it was really important to have a tight relationship at that time."

Once the crisis had subsided, the level of involvement from the board reduced, "because they knew we had the right policies in place to manage these exposures, and they knew we had the finance audit committee watching over us still. So they step in and out – but a critical role of the board is to make sure that treasury is focused on the right thing at the right time."

Equally, Ceran notes the importance of making sure that treasury is equipped to handle any future crises that might occur. "As treasurer, I always lobbied for the appropriate amount of headcount," she says. "I never wanted to have more people than the average group, but I also didn't want to have too few. I felt that in a crisis, if you have too few people who aren't strategic in understanding risk, that's when you can find yourself in trouble."

Bridging the knowledge gap

Some treasurers are more equipped than others to present effectively to the board. "Writing board papers, and not making them too complex about certain technical banking and treasury topics, is an art," says Stebbings. "This doesn't just apply to treasury matters, but to any technical risk topic the board might need to discuss, such as cybersecurity or key operational risks – when you're talking to people who do not have a deep technical view, then it's important to communicate effectively and make it relevant to them."

Levels of treasury knowledge can also vary significantly between different boards. Stebbings notes that some treasurers have made their way onto the board via the CFO role, while many boards have members with banking experience "who have an understanding of treasury and financial instruments, but may look at it with a different lens."

In some cases, there may be an opportunity for treasury to help bridge any knowledge gap that might exist. When she joined eBay, Ceran set up a Capital Markets Review Committee to build a greater understanding of treasury and risk within the business. "In any case, part of presenting is to educate everyone on the board about what the risks are and how you can or can't manage them," she adds.

But as Ceran points out, "Board members are very experienced and savvy, and in the last 15 years they have become more informed. They may not technically have worked in treasury operations, but at a high level they are well educated and understand the impact of changing interest rates, bank failures and significant movements in foreign currency. I haven't seen a situation where these things are brought to the board, and somebody can't contribute." ■

Treasurer as board member

In some cases, treasurers are increasingly recognised as professional risk managers that can play a significant part in the overall corporate governance and strategy of the company. As such, Polykrati says that appointing the treasurer as a board member "is a trend that's just starting to pick up, depending on the industry and the company's activity."

"Treasurers bring deep expertise in financial management, risk assessment, and capital allocation to board discussions," she says. "Their presence enhances the board's understanding of complex financial matters, and ensures that treasury-related decisions align with broader corporate objectives."

Polykrati adds that having a treasurer on the board "can improve communication between the treasury department and the board, leading to more informed decision-making and better risk management."

Driving a culture of continuous improvement

Patrick McCartan
Vice President and Treasurer

Caterpillar Inc. is the world's leading manufacturer of construction and mining equipment, off-highway diesel and natural gas engines, industrial gas turbines and diesel-electric locomotives.

Caterpillar does business on every continent, principally operating through three primary segments – Construction Industries, Resource Industries and Energy & Transportation – and providing financing and related services through its Financial Products segment. Founded by Benjamin Holt and C L Best over 100 years ago, today the company is backed by a global dealer network.

Patrick McCartan, Vice President and Treasurer at Caterpillar describes a leadership style based on nurturing talent and explains why innovation should never end.

Patrick McCartan, Vice President and Treasurer at Caterpillar, the construction and mining equipment manufacturer, joined the group 28 years ago, straight out of college. When executives from the company's treasury and accounting team presented at a careers evening at Iowa State University where McCartan was in his last year studying finance, he was immediately enthralled. Joining a mid-West bank – where he'd already had an internship – was out. Replaced instead by an interview and job offer with the industrial company known for its iconic yellow bulldozers and building site machinery.

"I was pretty convinced I would go into banking, but I was blown away by the company and its leaders," McCartan recalls in an interview with Treasury Today from the company's Irving, Texas headquarters.

Reflecting on his career, McCartan says Caterpillar has delivered on everything those company executives promised their student audience back in the 90s. It began with what he calls a 'foundational decade' developing new skills spanning funding, dealer finance and risk management, moving around the company and working overseas. More recently, he's gone on to achieve multiple career goals, including key leadership roles and driving innovation across global finance.

Mexico City

Straight out of college, McCartan was posted to Caterpillar's Latin America Distribution Services Division as a financial rep. His job was to support the financing and liquidity needs of the company's independent dealerships in the region so they could grow their own customer base. "Caterpillar has robust processes in place to ensure the dealerships maintain their financial strength," he says. He adds that this early initiation into Caterpillar's distribution services was a chance to learn more about the dealer network and its importance in the company's strategy.

After five years in the Distribution Services Division that included a stint in Mexico City where he met his wife, he moved into corporate treasury. Working in risk management within corporate treasury, he got his first taste of FX trading and managing commodity risk, learning how to oversee large exposures across different markets, and gaining insight into the company's risk management philosophy.

"At that time in my career, it did feel like a lot of responsibility, but Caterpillar does a very good job of giving responsibility based on experience and skills. It was my responsibility to create the strategies, but I had a leader and reviewed everything with them. It says a lot about how we develop people on the job," he recalls in a recurring theme.

Other standout assignments back then included joining Caterpillar's 6 Sigma programme, housed in the financial services team. It was an opportunity to learn the ins and outs of Total Quality Management (TQM) pioneered in the 1980s at Motorola and developed at other organisations including Bank of America, Honeywell International and

Caterpillar has robust processes in place to ensure the dealerships maintain their financial strength.

General Electric. It was a role that McCartan admits he didn't initially seize.

Twenty years on and now leading the integration of new systems upgrades and processes across treasury, he is grateful for that experience. He still calls on the key lessons it instilled around the importance of the correct processes and controls, and how to drive efficiency. "You never really know all that you will learn in a position," he reflects.

After completing the 6 Sigma programme, McCartan landed in Luxembourg in another treasury role. This time his focus was intercompany funding where key learnings included getting to grips with the legal framework supporting intercompany lending processes. It wasn't long before he was assigned his first senior leadership role as Director Corporate Funding, stationed out of Caterpillar's corporate headquarters in the US, tasked with managing corporate funding (external and internal), cash deployment, and rating agency and bank relationships.

By now it was 2009, and McCartan stepped into his new role just as the GFC-induced global slowdown began to bite. Although Caterpillar recovered quickly, he recalls hectic months in treasury, charged with ensuring the company's subsidiaries had access to all the funding they required. "We were the inter-company bank that handled all funding from the centre. Our role was critical for Caterpillar's subsidiaries around the world."

Industrial bellwether

It leads McCartan to reflect that his toughest days in treasury have always been during the inevitable business troughs that hit the cyclical sector. "I've got used to it, but it's still, always, challenging," he says. One silver lining inherent in periodically tough trading environments is that they provide rich learning opportunities.

For example, the GFC carried the seeds of a new focus on safeguarding the company's Single A credit rating and treasury put in place enhanced processes to shore up Caterpillar's financial strength over time with clear priorities for cash deployment.

Today, Caterpillar's priorities include meeting targets for a diverse group of financial metrics that focus on liquidity, leverage, cash flow and margins that align with the company's cash deployment actions. They reflect the cyclical nature of the business and allow the company to be nimble around leverage and liquidity over time. This gives the team a more

> We are now working with digital technology to drive more automated forecasts using AI. It's really exciting.

flexible structure so they can react more quickly to changes in supply and demand, he says.

"You have to go through tough times to support this kind of change. The business recovered quickly after the GFC, but it exposed lots of things we needed to do better."

Iterative reforms to liquidity, funding processes and governance, added since the GFC, meant treasury was well prepared to cope when the COVID trough hit. "We really pride ourselves on our ability to learn from different challenges we face and our ability to build skills. Although it is difficult to predict economic twists and turns, this type of robust risk management means the company is prepared for whatever comes our way," he says.

Driving efficiency

Today, much of McCartan's role involves integrating digital processes as Caterpillar seeks to simplify and standardise the processes in its finance function. For example, recent efforts to drive simplification and standardisation across several functional areas in treasury from front-office to back office include standing up a new (global standard) treasury tower in Bangalore.

In another project, the treasury team are developing AI forecasting abilities in-house. "For years, large, global teams have been involved in bottom-up forecasting at the company," he explains. "We are now working with digital technology to drive more automated forecasts using AI. It's really exciting."

McCartan says using technology to develop forecasting tools is a disciplined process that requires experimentation and room to make mistakes; being open to change and a preparedness to accept a new way of doing things. "The first time you run new processes, you won't get better results," he says.

Still, he notes steady improvements in the accuracy of reporting and forecasting every quarter and says excitement levels and trust in the new technology is mounting amongst the team. "The goal is to get to the point where we can turn off the bottom-up," he says.

One of the most thrilling aspects of introducing AI is the gradual upskilling of treasury staff, particularly around applying Microsoft 0365 technology and using multiple apps.

Treasury is streamlining processes in ways that would not have been possible even five years ago, he continues. "We realised that digitalisation is a crucial part of the global finance structure, especially analytics-based forecasts and normal continuous process improvement efforts across the team. Alongside doing their day job, people are focused on learning these new tools and we are doing a lot in house, which is really neat."

"We have much better dashboards today and more information at our fingertips. It enables treasury to partner with the business to make strategic decisions quickly. We are also working more flexibly than before, which gives our people the ability to better manage their work/life balance," he continues.

McCartan views the latest technological developments in Caterpillar's treasury as part of a long trajectory of gradual digitisation. For him that began when Caterpillar implemented an inaugural TMS back in 2003. "We have continued to evolve our approach as new technologies come on the market. What I have learned is that you must constantly look for ways to improve processes and focus on creating value. You cannot be complacent."

"Over the course of my career, I've seen constant evolution in the treasury department driven by advancements in technology, the expansion of available products, as well as changing regulations and accounting guidelines."

McCartan describes a discipled and focused approach that is informed by market-leading processes and external benchmarks as well as networking and learning from treasury peers that have developed their own, best in class approaches.

Currently he's on the lookout for insights on how digital tools can work across multiple Enterprise Resource Planning systems and how to streamline Caterpillar's ability to make process improvements against the backdrop of a fragmented regulatory environment. "The current fragmented regulatory environment has an impact on both our business and process partners such as banks, insurance companies and asset managers," he says.

Fittingly, McCartan concludes by circling back to the type of person he seeks to recruit amongst the current graduate cohort eager to join the company. Integrity, strategic thinking, business acumen and leadership capabilities are all essential, he lists. "The foundation of a good treasury department is having the best talent," he says.

"It's the Caterpillar culture and the commitment of our people that has shaped my career and will ultimately be crucial to nurturing the next generation of leaders as well. To attract the best people, the whole team needs to be involved in recruiting and onboarding; professional development, on-the-job training, and career planning." ■

BEWARE OF THE DEEPFAKE CFO

Could you be tricked by a deepfake video call purportedly from your CFO? Two experts explain how treasurers can protect their companies from the latest cyberattacks.

Since the pandemic, businesses have increasingly embraced video calls via platforms like Zoom and Microsoft Teams as a convenient way of communicating with colleagues in different geographical locations.

Last month, however, the risk of falling victim to a video call scam was laid bare by the case of the employee of an unnamed Hong Kong company who was tricked into paying fraudsters HK$200m (£20m) during a video conference, following an earlier email purporting to be from the company's UK-based CFO. Unlike previous scams of this type using one-to-one video calls, in this case the finance worker believed they were speaking to a number of other employees.

"I believe the fraudster downloaded videos in advance and then used artificial intelligence to add fake voices to use in the video conference," explained acting senior superintendent Baron Chan during a press conference. The worker in question made 15 transactions to local bank accounts, only to realise the mistake a week later.

"For someone to make payments off an instruction given on a video call does call into question how stringent their processes are," comments Royston Da Costa, Assistant Treasurer at Ferguson. "But nevertheless, what people will be saying is, 'if you can be fooled by a video call – not just through an email – the requirement for robust procedures becomes even more paramount.'"

Processes and controls

Da Costa argues that this incident highlights corporates, banks and fintechs need to evolve in terms of how technology is used. Likewise, people should think about how they would react if they were targeted as individuals. One example he has come across is of a family that has a secret password, "whereby if one of their members were to get a call saying that money needed to be transmitted urgently, they would need to use the password as a way of identifying themselves," he notes.

Likewise, while there is "no substitute" for segregated control processes for making payments, he argues there is a growing need to think about how people can be identified or validated. "Banks need to use technology so they can properly identify the person who's making that payment," he adds. "And similarly, corporates need to look more closely at their processes."

Staying one step ahead

According to Jon Paquette, EVP of Solutions and Strategy at TIS, "This latest attack highlights the pace at which fraudulent threats are evolving in the financial sector and signifies the challenges treasurers face in staying one step ahead of the perpetrators."

To protect against these new-age threats, says Paquette, corporate practitioners need to prioritise a multifaceted approach. "First off, it's crucial to foster a culture of awareness and education within the organisation, ensuring all employees know how to effectively recognise and respond to the attacks they may encounter."

Secondly, Paquette says treasurers should secure their payment processes through technologies that enable straight-through-processing and minimise the level of human intervention. "Executing manual payments should be a rare exception to the status quo, and these should be further secured with stringent controls that reflect the increased risk they pose," he comments. "Technologies that enable multi-factor authentication (MFA) and user management based on principles of least privilege are another critical component of securing these processes as well."

Finally, as fraudsters continue to leverage new and emerging technologies to enhance their attacks, Paquette argues it "only makes sense" for treasurers to protect themselves in a similarly advanced fashion through the deployment of modern fraud detection software. "If implemented correctly, these technologies can be an essential last line of defence for identifying and preventing sophisticated fraud attacks, thereby protecting organisations against both financial and reputational loss," he concludes. ■

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How ABB Group digitised its export trade finance function

An export trade finance solution that centralises an element of ABB Group's trade finance operation by introducing a new wave of digitisation is proving transformative. Digitising trade finance is enduringly difficult, but Treasury Today interviewees say evolution not revolution will gradually end manual processes.

Digitising trade finance is notoriously difficult because of the lack of harmonisation, and technology gaps. But Felix Meyer and Petra Hunjet-Moison at ABB Limited, the corporate treasury arm of Switzerland's industrial conglomerate ABB Group, say they have made a leap forward in export trade digitisation at the company following a process-led technology implementation.

Meyer, who leads Treasury Technology and Hunjet Moison, Global Head, Export and Trade Finance, tell Treasury Today how a new export trade finance solution that centralises an element of ABB's trade finance operation and introduces a new wave of digitisation in hitherto manual processes is proving transformative.

Export trade finance at ABB spans typical trade finance activities, concentrated mainly on guarantees and letters of credit alongside managing various accounts receivable and supply chain finance programmes.

"In addition, we arrange financing with our banks so that our customers can buy ABB products," explains Hunjet-Moison. Overseeing thousands of performance guarantees, often with unique characteristics, is perhaps the most challenging aspect. Issued by banks and insurance companies (in markets like the US) these guarantees promise that ABB Group will fulfil its underlying contract to customers, acting like a traditional warranty on any purchase.

Meyer and Hunjet Moison's treasury overhaul has focused in this corner of export and trade finance particularly. ABB has just finished rolling out new processes and architecture to support how it issues performance guarantees, digitising and standardising these trade instruments. The new processes digitise all requests for performance guarantees automatically via one system with full visibility at a central level.

To date, workflows and reports from some 80 countries have been onboarded and around 27,000 guarantees have been migrated in seven waves from more than 100 banks and insurance companies.

Under the new system, a central treasury team now requests that banks and insurance companies which issue guarantees on its behalf use either Swift or a web enabled interface. "Our main goal was to automate and use Swift to automatically process the guarantees as the standard," explains Hunjet-Moison, who says that the process had to use two channels so it could cater to guarantee providers unable to tap into Swift.

"Insurance companies issuing performance guarantees and some of the banks in remote locations are not on Swift," she explains. "We needed an alternative whereby this cohort could log onto our system and take care of all the correspondence without a paper trail. We wanted to get rid of manual, fragmented processes."

Standardising Swift processes for trade finance with existing Swift standards was a particularly knotty process. "Swift and market participants have traditionally left discussions on trade finance message standardisation off to the side, favouring instead standardisation strides in the payment sphere through its ISO 20022 migration," Meyer states. "As a result, every bank has quite a bit of leverage regarding how the contents of their message are organised. This has pushed the burden to the vendor and corporate to ensure proper message preparation and interpretation."

The ABB team had to analyse these specifications per bank in a time-pressured process that also involved negotiating a raft of Swift agreements.

"We discovered that the negotiation process for SCORE agreements – even as addendums to existing payment agreements – was quite time and resource intensive. On the implementation side, although Swift MT 798 format and the larger MT 7xx message family provide a multi-bank message structure for import/export guarantees and standby letters of credit, the format leaves ample room for flexibility and bank-specific specifications," says Meyer who chairs Swift Corporate Group Switzerland (SCG-CH), which lobbies the payments giant on behalf of treasury teams for the country's largest corporates.

The next challenge came in moving the data from the legacy solution, including transformation and data cleansing elements. The documentation-heavy nature of trade finance contracts also required that attachments were correctly linked to the underlying guarantee or surety.

"We had 27,000 guarantees which equates to tons of documents to move over. It's difficult to get some messages imported into our system but we did well. We had under 4% of failed records!" said Hunjet-Moison. She attributes much of the success to clever IT colleagues running a BOT to ensure speed, precision and repeatability of the migration and extensive clean-up activities prior to migration.

The overhaul was completed in a tight timeline that included extensive testing for the trade instruments with all the banking counterparts. This involved organising the transfer of credit lines between legacy and new systems and enabling implementation of standardised approval levels across all markets, like India, where the team had multiple approval levels.

"Now, all ABB internal approval levels for guarantees, no matter what country, are the same," she says. "Local guarantee and letters of credit systems used in some countries have been discontinued." The transformation was carried out by around 15 staff with different business, technical and legal skills.

ABB's overhaul began in 2021 when it issued an RFP to explore the best providers in the market. In the end, Meyer and the team decided to procure an off-the-shelf solution that enables small, minimal customisations.

"Moving to a software-as-a-service (SaaS) solution offered many advantages from a technology and hosting perspective. Despite pushing us to move to a more standardised solution with limited flexibility, the supplier agreed to make some customisations that benefitted the larger user base" he said. "We hope to see a return on investment in two years."

ABB is already planning how to continue its digitisation journey, building on both its new processes and technology. One ongoing initiative targets more centralisation of operations to better support customers, ultimately boosting and facilitating sales. For example, technology driven initiatives include tighter integration with TMS and accounting systems for the purpose of payment automation for fees, still a highly manual process. ■

Evolution not revolution

Trade finance may oil the wheels of the modern economy, but as the world digitises, it remains stubbornly rooted in paper processes. Many of the business documents underscoring trade which create trust between a buyer and seller, ensuring payment or delivery of goods, are still written on paper.

Like the fact only an estimated 1% of the four trillion paper bills of lading – just one of many trade finance documents, that details goods in transit – exchanged every year are digitised. Meanwhile, the use of paper by stakeholders in the chain from banks, insurance companies to customs and buyers and sellers, requires huge resources and expense, complexity and processing time.

Still, real progress digitising payments and receivables is evident, and cast progress through the lens of evolution not revolution, and change is happening.

A lack of available technology is not the problem, explains Marie-Laure Gastellu, Global Head of Trade Finance at Société Générale (SocGen). "The availability of standards and legal frameworks must be accelerated," she says. Broadly, standards refer to the ability of trading partners and other participants in the value chain to speak the same language and match information on their different platforms. And standardisation – the hot topics amongst trade bodies – is difficult to achieve at scale given trade finance involves so many different actors using a variety of platforms.

But standards are being developed. Like the International Chambers of Commerce (ICC), publishing rules that stakeholders must comply with if they want to exchange e-documents. Other signs of uniformity have come from Swift which has published a strategy in support for global trade that puts standards at the forefront. "The ecosystem is making significant progress. There are so many different players across the trade value chain and so many documents in a letter of credit, it will take time to achieve digitalisation at scale, but I am convinced that we are on an accelerated path," she says.

Important milestones include the UK becoming the first G7 country to pass the Electronic Trade Documents Act (ETDA), which enables trade documents to be held and transacted in electronic format. "ETDA was an example of English law leading the way on the digitisation of trade," says Geoffrey Wynne, Head of Sullivan and Worcester's Trade & Export Finance Group. Similar iterations are now under review in France and will be transposed into French law. Germany is also looking at it.

Progress is also being made around electronic bills of lading. Shipping companies, which operate in a concentrated market where around ten companies control nearly all trade flows, have pledged to digitise bills of lading by 2030. Elsewhere, many of the fields in a typical Letter of Credit are now electronic in some shape or form. "We are quite a long way down the road," observes Wynne.

Elsewhere, Letters of Credit are now underscored by "soft rules" drawn up by the ICC and commonly accepted by the entire trade finance industry and the same for everyone, continues Gastellu. "At the end of the day, if we can achieve a legal framework, technology adoption and capacity to develop shared standards, that's how we will achieve digitisation at scale for the benefit of the entire ecosystem, starting with SMEs. We need to have the three bricks in place: a legal framework, standards and technology."

One hurdle to progress is the cost of integrating digital processes. Large banks or trading companies can afford to invest in the technology, but smaller companies or sole proprietors can't. "Entry costs are holding back digitisation," says Wynne, mindful of the irony that investment in digitisation will lower the cost of trade and doing business from compliance checks to back office paper processes. Gastellu says new technology at SocGen is already cutting costs like automating flows between corporate clients and the bank. "Receiving the information digitally creates lots of efficiencies."

Digitisation will continue, and the more it is talked about it, the more it will happen. But one key bottleneck remains. Buyers still want to physically check their goods – and nothing quite transfers ownership like a piece of paper.

"Ninety percent of the tasks being done by machines is fine, but when the machine says it looks good to me, I will still want to have one more look. I'm not saying we are not progressing. I'm just saying that full automation won't happen. We are not going to part with the goods until we've had a final check," concludes Wynne.

Funding woes impact payments innovation

The buzz around fintech start-ups and new ways to pay has waned now that venture capital funding has dried up. Investors' pursuit of profitability over growth is having an impact on the type of innovation that will be pursued, but corporates can still expect to see new solutions come their way in the future.

The payments industry has long been working on solving customers' pain points and making transactions simpler, quicker and cheaper. One of the problems was that men were wearing ill-fitting suits because their wallets were stuffed with cash, jokes Lee Britton, Director of the Money Service Lab. Such problems have been fixed with the drive towards a cashless society, where digital payments have become the norm. Britton has worked in payments innovation for decades, bringing cashless solutions to transport networks, football stadiums, government benefits programmes, and more – as well as removing the need for a physical wallet.

Through those years Britton has seen many cycles of boom and bust – and hubris and humility. And now, after a golden period for fintech start-ups, where there was much buzz about the firms that were changing the way we pay, the industry is undergoing a correction. Many start-ups are now struggling to find funding, which is impacting the kind of innovation that will be pursued, and ultimately feed into the way that corporates manage their payments.

Venture capital (VC) funding has dropped off in recent months, and KPMG noted in its Pulse of Fintech survey how 2023 was a difficult year for all financial technology companies, not just those in payments. KPMG noted that Asia Pacific experienced the largest drop in investment from 2022's figure of US$51.3bn to US$10.8bn in 2023. Meanwhile Europe, the Middle East and Africa had a drop in investment from US$49.6bn to US$24.5bn for the same period. Although the fintech sector has been struggling, payments are still gaining a lot of attention, and attracting the lion's share of investment. Despite this, however, the payments sector still had a drop from US$57.9bn to US$20.7bn between 2022 and 2023.

The KPMG report highlights a number of difficulties last year: high interest rates, high inflation, geopolitical uncertainties with the conflict in Ukraine, and also concerns with company valuations. With these factors at play, a number of trends are emerging: investors are focusing on profitability rather than pursuing growth, and deals will be subject to greater scrutiny. Also, there is now a greater interest in business-to-business solutions rather than those that focus on consumers.

The gloomy environment has been having an impact on the state of innovation in the payments sector, and this is a topic the Payments Innovation Jury 2024 looked at in detail, the findings of which were published in a report entitled, 'Market Meltdown: Impacts on infrastructure, regulation and innovation'. The report notes that tumultuous changes in the payments sector began in 2022 and continued into 2023, which has been accompanied by a downward correction in the valuation of payments companies.

Although many start-ups previously raised funds in a low-interest rate environment where money was cheap, the Payments Innovation Jury found that the over-valuations of companies was driven more by investors bidding up deal prices and paying insufficient attention to profitability.

Those boom times are over, and the dearth of funding in recent years has been dubbed the 'fintech winter', or more broadly the 'VC winter'. John Chaplin, the Chairman of the Payments Innovation Jury, tells Treasury Today that the problems that payments companies are currently facing did not start with investment being restricted. "It's a bit like house prices," explains Chaplin. "Prices have started to move down and so the supply side has changed."

For a while in the industry, comments Chaplin, there was the belief that if start-ups kept growing it didn't matter if they weren't profitable; they believed if they kept spending money and growing fast they would eventually get profitable. That didn't prove to be the case. Faced with difficult times, many realised they were actually going out of business. Even if they cut costs, it meant they would go bankrupt at a slower pace, says Chaplin.

Commenting on the current state of the fintech industry, Anton Ruddenklau, Global Head of Fintech and Innovation at KPMG International, who authored the report stated: "Looking to 2024, it's going to be a buyer's market. There's going to be a fire sale. There has to be a fire sale because a lot of the incumbents can't afford to keep running anymore. They've run out of funding pathway and their investors have no stomach given how the environment has shifted. Fintechs that have been disrupted somewhat by new

technologies – particularly generative AI [artificial intelligence] – are definitely struggling."

The Innovation Jury notes that investment levels in payments have now tumbled and there has been a diversion of investment into other sectors, such as AI. This ultimately will impact the kind of innovation that is likely to come in the future for the payments industry. Patricia Hines, Head of Banking, Wealth and Risk at Celent, comments, "In addition to a lack of early-stage funding, payment start-ups face rising concerns over perceived and real fraud."

Hines explains that because companies are being required to shift focus, and resources, to developing robust fraud mitigation strategies, this exacerbates the already-limited budgets of start-ups. "At the same time, regulatory and compliance oversight is tightening, potentially stifling innovation efforts as a result of decreased focus. Although not necessarily a direct result of increased oversight, the rise of regulatory fines and actions makes start-ups less attractive to risk-averse financial professionals."

For entrepreneurs building their payments companies, there are many costs that come with getting their idea to market – such as fraud mitigation and regulatory compliance. Chaplin comments that many companies were playing a scale game. They built platforms and assumed their costs would be fixed and would have to add payments volume to make their venture worthwhile. However, "fraud losses are real costs" Chaplin says. Also, these companies made the assumption that they would only need to invest once in the platform, and didn't account for the fact they would have to keep investing to adapt to changing regulations, and also keep their position in the market.

Britton also comments on the fast-evolving nature of the technology: "Previously people would tell you that the technology was disposable, and you could write it off over ten or 20 years. Now it is becoming obsolete in three to five years. The return on investment has to be real," he tells Treasury Today.

In the current environment, start-ups are being hit the hardest. Does the early focus on returns and profitability mean that the most innovative ideas may never see the light of day? Quite possibly. Britton comments that start-ups are "now not letting their minds wander and have to execute on a very specific business plan," especially in an environment where the cost of capital is much higher because of higher interest rates. This specific plan, for example, may mean that a company "won't be doing anything funky" and will delay its expansion to other regions, such as North America or Asia, until after the company is profitable.

Given the lack of funding available for start-ups, and the increasing burden of regulation, much payments innovation is occurring within financial institutions. There was a cycle of banks not building themselves – because of the rise of the likes of ApplePay, for example – but now things have gone full circle to banks building their own solutions, comments Britton. This is in line with what Hines at Celent is seeing: "In a bold move to stay competitive, many banks are rolling out their own cutting-edge payment solutions. They're either fully harnessing their internal capabilities or forming strategic partnerships to introduce services like BNPL [Buy Now, Pay Later], pay-by-bank, instant payments, QR [quick response] code payments, digital wallets and marketplace payments."

Much of these trends are relevant to corporate treasurers, because – as Hines explains – they are impacted directly by what happens in this space. "Many treasurers are in the thick of payment innovation, especially those in direct-to-consumer industries such as retail, hospitality, healthcare and insurance. In these industries, treasury and finance teams must handle increasing high-volume, low-value transactions, making reconciliation across the enterprise even more challenging," Hines says. "Treasurers also understand the imperative to improve the shopping, patient or consumer experience. This starts with flexible payment options and payment choice, accessible through intuitive digital channels," she adds.

How closely should treasurers follow the developments in payment innovation; do they need to, or could they let their banks do it for them? "Regarding whether treasurers should leave payments innovation up to their banking partners, the short answer is 'yes'. Banks, especially the largest ones, have substantial technology budgets, risk frameworks, contract attorneys, product managers, and integration teams. Although leveraging bank payment solutions may offer less flexibility, the corporate avoids upfront licensing fees, implementation costs, and system integration challenges," says Hines.

There are a number of innovation trends that are likely to impact corporate treasury. A report released by HSBC in January 2024 entitled 'Global payments trends: Considerations for corporate treasurers' noted how there is a broader shift to global cashless payments, with digital payment volumes projected to increase by more than 80% from 2020 to 2025 from one trillion transactions to 1.9 million. The HSBC report notes a number of future payments trends that are relevant to treasurers, including distributed ledger technology, generative AI, Web3 and the metaverse, embedded payments, cross-border instant payments and central bank digital currencies.

Hines comments on how treasurers need to keep an eye on how consumers are changing the way they pay at the point of sale, as well as the wholesale infrastructure that makes their liquidity and cash management more efficient. Hines says: "The shift to digital payments and payment choice, along with other impacts such as the ISO 20022 migration and payments fraud, necessitates improvements to the point-of-sale as well as payments back office infrastructure, both for banks and their corporate clients. These changes reflect a broader evolution in the payments industry driven by technological advancements, changing consumer preferences, and the need for more efficient and secure payment methods."

Chaplin comments there is much interest in real-time payments as well as account to account payments, but he expects to see a difference in uptake according to the region. For example, in developing markets where payment cards did not gain a foothold, account to account and mobile money will build a major market position. Meanwhile, cards will be hard to dislodge from their incumbent position in developed markets. Chaplin points out that even where smartphones and digital solutions are used in developed markets by consumers, even though the physical card is no longer necessary, the payments are still being run along the traditional banking and payment network infrastructure.

For now, although payments start-ups are struggling, there is still a wider drive to digital payments and new ways to pay – and also a world where wallets aren't stuffed with cash. ■

Derivatives demystified

Managing risk is a critical concern for treasurers. One way to manage exposures is through the use of derivatives instruments – so how essential are derivatives when it comes to managing risk? And to what extent are treasurers concerned about their complexity and possible risks?

Protecting the organisation from risk is a key concern for corporate treasurers. And when it comes to managing risk exposures, treasurers have several options available to them. They can choose to do nothing; they can hedge the exposure naturally – for example by offsetting a foreign exchange exposure against receivables in the same currency – or they can take action in order to manage the exposure.

In the latter case, one option is to use derivatives to hedge risk. In a nutshell, a derivative is a type of financial contract between two or more parties, which can be traded either on an exchange or over-the-counter. Common types of derivatives include forward contracts, futures, options and swaps:

- Forwards are contracts that are privately negotiated between two parties to buy or sell an asset on a future date, at a price agreed in the present (the strike rate). In the context of foreign exchange, this could mean agreeing the exchange rate today for a foreign exchange transaction in four months' time.
- Futures likewise allow two parties to buy and sell an asset on a specific future date for an agreed price.
- Options give buyers the right to buy or sell an asset on a future data at an agreed price – but unlike forwards, the buyer is not obliged to buy or sell the asset when the time comes. As such, a premium is paid.
- Swaps are derivative contracts in which two parties exchange the cash flows or values relating to specific assets for a period of time. For example, a company might use a swap to turn fixed payments on debt bonds into variable rate payments.

While derivatives can also be used for speculative purposes, in the context of treasury they are used to mitigate a variety of risks, such as foreign exchange risk, interest rate risk and commodity risk.

As Jason Teo, Head of Treasury, South East Asia at LOGOS Group, explains: "We have been adopting a prudent capital management approach, and risk management serves as a bedrock of treasury management in LOGOS. We tend to seek for natural hedge (onshore debts) and enter into interest rate derivatives (swaps, caps, collars) to mitigate FX and IR risks respectively."

Teo explains that the company has policies in place to provide guidance and avoid "speculative and emotional play" when markets are unfavourable and uncertain. "As an advocate for risk management, hedges entered previously were all in-the-money during this high interest rate environment, resulting in lower interest expense for the company," he adds.

Harnessing derivatives

While derivatives play a key role in financial risk management, it's important to understand how and when to use them – and equally, that derivatives are not always needed. As Agustin Mackinlay, Senior Financial Writer at currency management automation software provider Kantox, points out, "Risk management is also about delaying the need to use derivatives – and even avoiding them altogether." If, for example, interest rate differentials between currencies are not favourable to the firm, "treasury teams can to some extent delay the execution of derivatives transactions."

In other cases, companies may be able to net out mutually offsetting positions, thereby avoiding the need to carry out derivatives transactions. "This allows companies to save on trading costs, and possibly to reduce financial costs derived from having to set cash aside as collateral for derivatives transactions," Mackinley notes.

With a thorough understanding of all aspects of the business, he says the use of derivatives can be a great way of actively embracing different opportunities in what is an "incredibly dynamic world". But on the flipside, he notes that the misuse of derivatives can wreak havoc on a firm's financial results and reputation.

"Derivatives should only be used in the context of hedging an underlying exposure that arises from a real commercial/ financial transaction," says Mackinley. "With hedging, the value of a derivatives instrument changes in the opposite direction of the change in the underlying asset/liability. If one goes up (down) in value, the other must go down (up) in value, by exactly the same proportion. When that relationship is not clearly established, the firm may be engaging in potentially costly speculative activities."

In recent years, technology has opened up new ways of using derivatives. "Financial derivatives instruments as we understand them have been in use for the better part of the last four decades now, although some versions are much older still," says Mackinlay. "Perhaps the biggest change in their use is driven by technology. The same instruments – for example, currency forwards – can be used to implement programmes that would have been considered too resource-intensive just a few years ago.

"This is the case of a 'layered' FX programme involving many currency pairs, or a micro-hedging programme that can execute thousands of derivatives transactions in different currency pairs, with markups by client segment and currency pair, and automatic management of interest rate differentials."

But while derivatives can be a valuable tool for managing risk, there are a number of reasons why companies may decide against using them.

Chris King is the former group treasurer of Drax Group and co-founder of corporate finance and risk management firm Dukes & King. He observes that while the use of derivatives can seem complicated, costly or even perceived as taking additional risk, "this usually stems from either a lack of understanding, and/or stakeholders coming across derivatives perhaps being used in suboptimal ways in their previous roles."

As King explains, "Clear, upfront communication can usually help bring internal stakeholders on the journey of understanding earlier and bring out any potential headaches allowing time to address them."

Derivatives in a low-volatility market

In practice, companies are not always proactive when it comes to making full use of derivatives. According to King, the last year has seen a theme of reduced volatility in most major markets, including equities, bonds/rates, credit and FX. That said, markets can shift quickly, with recent developments including a rapid increase in equity volatility pricing (VIX).

During a period when the price of derivatives has been at or close to historic lows, King says there has been a clear opportunity for companies to use options to protect their near-term cash flows or enable future strategy. "For example, a business exposed to GBPUSD weakening might be able to protect the medium or long-term at levels that had only been cheaper only 1% of the time, historically speaking," he says.

But despite this opportunity, actual transactions or flows into risk protection have remained at all-time lows. King argues that there are a number of possible explanations for this juxtaposition.

For one thing, many companies survived the pandemic despite a lack of planning for an event of this kind. "This possibly also gave a sense of futility in planning for future events, and a feeling that there is little point in doing so until an event materialises," muses King. Meanwhile, muted volatility post-Covid means that many protection strategies will have likely expired worthless, causing stakeholders to question their value – although as King notes, people are not unhappy if an annual car insurance policy expires without an accident having taken place.

A further consideration is that trying to determine the most appropriate structure and risk approach can be daunting, given the large number of approaches available. "Even if the treasurer has the requisite skillset to come up with a narrower range of structures, the board or internal risk team may not have the capability to respond to them," he adds.

In light of these stumbling blocks, King notes that treasurers should consider the following questions when looking at a protection strategy:

- What does the business plan sensitivity modelling indicate, and which derivatives could be undertaken to protect the firm and put it in a position of strength?
- How can you get engagement from stakeholders for any protection strategies?
- Where advisors are concerned, what resources do you have available to help consider the overall strategy, structuring or execution? This may include internal resources, external advisors or banking specialists. ■

Derivatives in practice

"All of Wolters Kluwer's treasury activities, including the use of derivative financial instruments, are subject to a policy of risk minimisation," says George Dessing, Executive Vice President, Treasury & Risk at Wolters Kluwer, which provides information services and solutions for professionals.

Dessing explains that the company uses derivatives to mitigate currency risks and interest rate risks, noting that "the group does not purchase or hold derivative financial instruments for speculative purposes" – rather, the purpose of these hedging activities is to reduce financial risks faced by the company. "Derivates are important in fulfilling our objective of risk minimisation, but Wolters Kluwer believes: 'the simpler the better'," he adds.

Where currency risks are concerned, Dessing notes that Wolters Kluwer identifies transaction and translation risks, with the transaction risk exposure within individual group entities seen as "relatively immaterial".

"The transaction prices invoiced to customers for goods and/or services are mainly denominated in the customers' local currencies," says Dessing. "Given the nature of the business, almost all related costs are also incurred in those local currencies. Derivative financial instruments to hedge transaction risks are therefore rarely used by the company."

While complex derivatives are sometimes needed to solve complex issues, Dessing notes that it is vital to fully understand the mechanisms of a derivative, given that the value of a derivative can fluctuate strongly over time. "You may need to modify or close a long-term derivative contract in the future, and you need to be aware of the variables that can influence the result," he adds. "In some cases, it may even be very unfavourable to close the derivative contract."

On another note, Dessing notes the importance of being able to communicate clearly about derivatives with internal and external stakeholders, such as the accounting department, tax, investor relations and auditors. "They may not have the same understanding of these products as you have, and entering into a derivative contract may have implications for their disciplines," he observes. "As we say in Wolters Kluwer, 'We are winning as a team, and we're stronger together', whereby we collaborate and share knowledge across disciplines."

Setting up a TMS

What should treasury consider when implementing a TMS?

Shailesh Bettadapur
Treasurer & VP
Investor Relations
Mohawk Industries

Mohawk Industries installed a TMS (Kyriba) in 2012, and I am consistently surprised that treasurers are still talking about the pros and cons of this technology. I'd guess conservatively that around a third of my peers don't have a TMS. The company has a reputation for being lean and, for treasury, this would be impossible without a TMS. Our treasury team is only five to six people which is quite small for a US$1bn company.

The main purpose of a TMS is to automate and, while at least in this still pre-AI environment it won't eliminate human tasks entirely, it does automate a number of non-value adding tasks that would otherwise require more people, resulting in both cost efficiencies and lower error rates.

For example, in our pre-Kyriba days, our treasury staff would have to use a few hours in the morning to download bank files to be used for positioning. Now, post-Kyriba, this is all done automatically prior to the start of the workday. We don't have to access multiple bank portals, we can see all of our cash and debt in one place, and it makes reconciliation must easier and faster. It also automatically posts transactions into our ERP system, getting rid of yet another manual process. We also manage our debt and investments through Kyriba, including both external and intercompany debt.

When we were searching for the appropriate TMS, we anticipated that the company would grow internationally, requiring us to buy for tomorrow rather than the status quo. At the time we thought we might go into China, so we also planned for the ability to see information in non-Roman letters. Also at that time, the cloud was a relatively recent concept, so we had to decide whether to store information on our own servers or put it in the cloud.

We ended up going with Kyriba which was a relatively young company at the time but, more importantly, a company for whom the TMS was the main product.

In the intervening years, we have had to update the system and add new capabilities. For example, none of us ever anticipated issuing debt at negative rates. And yet we did in our euro commercial paper programme, which became a problem for Kyriba – it would view it as a mistake and kick it out – requiring Kyriba to rewrite part of the code. We have also added in functionality around cash investments.

It doesn't have to be particularly costly to integrate or run a TMS, and in any event, the cost should be viewed in the context of the people you don't have to hire and the errors you don't have to fix. Our fee structure works whereby we pay a fee for the system and a fee for each module, as well as transactional costs. But that's pretty standard. One of the good things is that we can get help from Kyriba when we need to add on functionality. For example, we didn't have to rely on our own IT team to write the new code around negative rates, which was a great benefit to us. IT departments have other things to do and have their own resource issues.

My final piece of advice is to make sure that your internal treasury group is actively involved in the implementation. You don't want to put out the entire implementation to your provider because, while they know their system and how it connects to the ERP and banks, they cannot really understand your business. They'll need your guidance on that.

Alex Wong
Head of Product Management
for Corporates, GTS EMEA
Bank of America

The main reason treasury introduces a TMS is for efficiency and to reduce errors. There comes a point in corporate growth when treasury needs better control over cash management and liquidity beyond what they can maintain either via spreadsheets or manual processes. The ability to process and utilise data to influence decision making is also a driving factor.

A typical new client exploring a TMS for the first time is an MNC with a turnover north of a billion. They might run several platforms off their ERP system and are now considering a step up to a full blown TMS. Scalability is also important – it's important to choose a TMS that can accommodate future needs and an increased volume of transactions from new markets.

The costs can vary. At the top of the range, a TMS can be fully integrated with a suite of functionality, risk management and reporting capabilities that include connectivity to payment processing. Maintenance, licencing and professional services costs come on top. Some TMS systems may be cloud based, and SaaS will reduce hardware costs. A third, hybrid system, will comprise components in the cloud and on-premises, depending on what kind of infrastructure treasury needs.

Implementation is guided by clear business needs and objectives and what treasury is trying to achieve. We spend time with clients advising them on similar projects and discussing the

long-term strategy of the company itself. Choose a partner that has a track record and can provide references that check out.

TMS doesn't function in isolation; it needs to be integrated with the company's existing systems like the ERP, accounting software, and the processes around how the company communicates with its banks to manage liquidity, transaction processing and funding. Treasury teams should also consider the extent to which they want to customise their TMS. Many companies don't leave enough time for implementation. In our experience it can take a few months to several years. But even if it takes several years, treasury will start to feel the benefits within a few months. For example, some of the data aggregation capabilities bring efficiencies quickly. Treasury should factor in time for pre-implementation, vendor selection, contract negotiation and project planning.

Typically, TMS implementation is overseen by at least one person who can liaise with the vendor and the internal tech team. Treasury needs to be there in the initial phase of customisation and validation to check implementation is done correctly, and don't overlook implementation complexity. Governance is also important, because TMS implementation requires a secure budget and support around information security and fraud protection. Other important partners include accounting because they will provide the data off which the TMS runs. Some elements of implementation can be time consuming like importing historical data, testing and training. Ensuring user adoption, and that people feel confident using the platform and don't stick to old habits is also important; effectively using a TMS requires coaching.

Matt Hook

Systems & Process Manager
Group Treasury
IHG Hotels & Resorts

At IHG Hotels & Resorts, the current TMS was not implemented as a direct result of our growth but rather from a general business review and audit into the systems we were using. In 2020 we introduced the current TMS which took around 18 months of planning and RFP work before we signed the contract. There were two main reasons for introducing the new system. Changes were coming up in Libor rates which we knew our ERP system wouldn't be able to adapt to without significant modification. Additionally, the swift platform IHG used was reaching its end of life.

We're generally really pleased with the functionality around payments, controls and auditing is made a lot less complicated when there is one central place to audit and report on instead of pulling reports from 20 or so different banking platforms. One point of access also gives us greater control and means better security when combined with a SSO system.

At IHG we have our own corporate swift code which means we receive bank statement messages directly into one central hub which helps with our cash visibility. Every day we receive a message from each bank account which gives us full visibility of our account balance which we can then pull into a report from the TMS. Another key functionality advantage is that TMS integrates very well with existing platforms that we already use, such as those for FX dealing, deal confirmations and money market transactions.

It's always a balance between costs versus benefits. Essentially, it's a case of evaluating whether the benefit of the system matches the cost of implementation. Our original expectation was that implementation would take around a year but with unique challenges posed by the pandemic this became nearer to two years. With offices closed, there was no physical collaboration meaning all demonstrations took place on video call which was a slight barrier to integration.

IHG has a very complicated business structure with hundreds of entities and so this will naturally incur a longer implementation time. Setting out a clear project plan from the offset of the process which is communicated across the business is important to ensure processes are followed and helps keep everyone on track.

Plan well and make sure you have the right people on board the project that fully understand the system and the ways to successfully implement it. A TMS can impact many parts of the business so having people with specific internal knowledge is incredibly helpful. As with any system change, there are some risks involved. For example, a worst-case scenario could mean the loss of vital functioning, data and a lack of understanding around the system.

The main risk is the loss of vital functions such as making payments but the way to mitigate this is parallel running. When we moved our payments, we did this in two stages, all of our payments were being made through the ERP and so we took the basic payment files initially and moved them to the TMS to make sure that the transmission and acceptance of the file was successful, all the time keeping the ERP available. Another major risk posed is if the brief and the system hasn't been fully understood. This issue is twofold – it may be that the provider hasn't fully understood what your needs are, or it could be that you haven't fully understood what the system can and can't do.

Involving subject matter experts is really important but striking a balance here is also crucial. The saying 'too many cooks in the kitchen' comes to mind – if there are too many people feeding back their opinions on the implementation of the process, it can become lengthy and there's a risk key information will be lost in translation. ■

Next question:

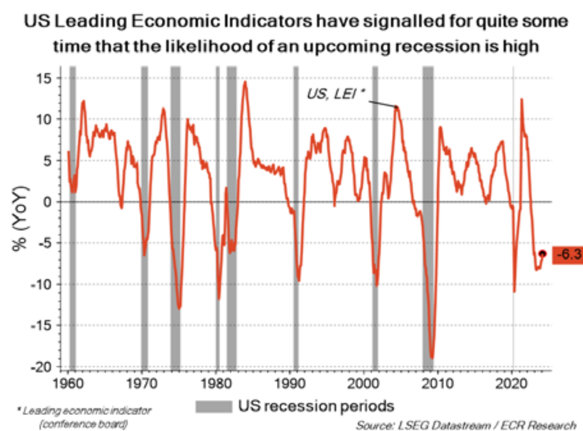
"How big a problem is trapped cash and what are the solutions?"

Please send your comments and responses to **qa@treasurytoday.com** by 20th May 2024.

Has the risk of recession disappeared?

After the Fed and ECB raised interest rates at a record pace last year to combat runaway inflation, it was widely assumed that a recession would follow. This was also evident in the behaviour of the economic leading indicators and the best predictor in this area; an inverted yield curve (where short-term interest rates are above long-term interest rates).

However, there are other factors that support the economy, including high asset prices and tight credit spreads and a very loose fiscal policy. The question this raises is whether we are too impatient and there will still be a recession, or if something else is going on this time.

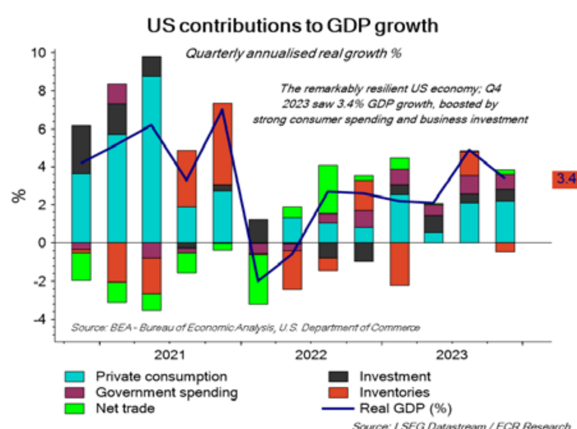


Two possible scenarios

Two different scenarios are immediately conceivable in the current situation. The first is that economies in the West will still slow significantly in the not-too-distant future because:

- The sharp rise in interest rates gradually starts to hurt more and more. Many parties had fixed the interest payable on their loans for an extended period of time when interest rates were so low. Gradually, however, these loans have to be refinanced at far higher interest rates. Also, new loans can only be taken out at higher interest rates.
- Consumers are now largely out of savings accumulated during the corona years.
- The effect of fiscal stimulus on economic growth is decreasing.

This scenario seems to be playing out in the sense that the Eurozone economy has stagnated in the second half of last year and the US economy was still growing by about 5% in the third quarter of last year, but fell back to about 3.5% in the fourth quarter and to about 2.25% in the first quarter of this year. This is therefore a clear downtrend.



The only question is whether one should look at it this way, since the 5% growth rate during the third quarter was abnormally high. The logical reaction to this is a few quarters of lower growth. Viewed from this perspective, the correction so far is actually not too bad. In Europe, growth is even picking up.

Here we come to the second possible scenario, one in which the economy remains resilient to tight monetary policy and higher real interest rates, due to a combination of the loose financial conditions (including high asset prices and tight credit spreads), a still elevated level of excess liquidity, tight labour markets – and thus high wage growth – due to ageing societies and the economic policy of reshoring.

A growing number of economists are wondering what the point would be of cutting interest rates quickly and sharply, and whether or not this entails too great a risk of resurgent inflation – especially against a backdrop where the Chinese economy is heavily stimulated and showing signs of increasing growth. This suggests that commodity prices will remain in an uptrend for now. This, in turn, must be combined with the following:

- The global economy has turned from deflationary to inflationary due to deglobalisation, increasing import barriers and tight labour markets.
- If growth is not going to fall back, labour markets will remain tight enough for wage increases to accelerate rather than decelerate.

ecr research

All things considered, one might indeed wonder whether too much risk with respect to wage increases and inflation would be taken if central banks were to start with sharp rate cuts before too long.

A combination of both scenarios is perhaps the most likely outcome.

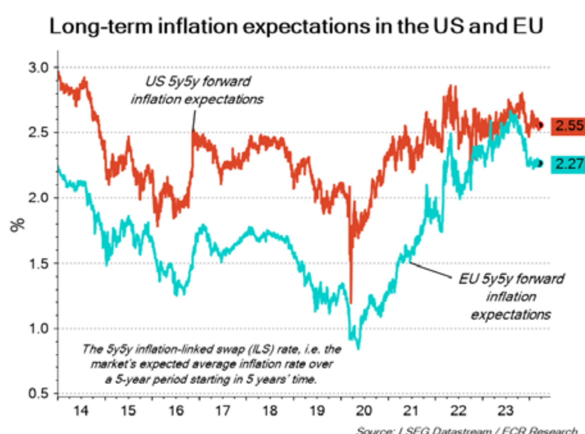
Growth in the European economy is picking up slightly and there is little indication that growth in the US is going to slow markedly to below 2-2.5%. Furthermore, it would not be surprising if commodity prices started to rise and import barriers were raised even further.

Finally, if growth continues to hover around current levels, the labour market will remain tight for the time being. However, a comment is merited in the case of the US.

Until recently, the Fed assumed roughly 0.5% workforce growth and 1.3% productivity growth. However, a recent study showed that the workforce is currently increasing by about 1.2% due to the return to work of people who had stopped working during the corona pandemic, but mainly due to far higher-than-expected immigration. Potential growth is therefore higher at around 2.5%.

This means that, under the current conditions, growth below 2.5% will cause rising unemployment as well as downward pressure on wage increases and inflation. But chances are high that, regardless of who wins the November election, immigration will soon be restricted to a far greater extent. Also, the return to the labour market of people who had left it during the corona pandemic concerns a one-time issue. Hence, we see potential growth gradually returning to around 1.8% from the end of this year.

Growth in the economy must then move below this level if the downward pressure on wage increases and inflation is to persist. Consequently, the number of rate cuts may well fall short of expectations for the time being.



We therefore assume for now that the following scenario is the most likely:

- We see growth in Europe and the US hovering around 0.75% and 2.25%, respectively, in the period ahead.
- The ECB will therefore continue to work towards lowering its rates. That is to say, four rate cuts of 0.25 percentage points will likely follow this year, starting in June. Next year, interest rates could be further reduced in four or even more 0.25 percentage-point steps. By contrast, in the US, we expect only two 0.25 percentage-point reductions this year – one in the third and one in the fourth quarter.
- Gradually, the negative points mentioned in the first scenario will start to slow down growth more.
- On balance, we see growth in Europe and the US hovering around 0.5% and 1.5%, respectively, from the fourth quarter onwards. This will result in downward pressure on wage increases and inflation. However, this downward pressure will be limited due to a persistent tight labour market and rising commodity prices.
- This still leaves scope for the Fed to cut its short-term interest rates four more times by 0.25 percentage points in the first half of 2025. In this case, we see ten-year US and German government bond yields falling to around 3.4% and 2.15%, respectively, in the coming months to quarters. ■

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