PwC Treasury Broadsheet

Quarterly newsletter of snippets and stories from the world of treasury management by PwC Treasury Advisory

December 2021

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Takeaways from the PwC Global Treasury Survey

As the year concludes, we wanted to reflect on some of the key treasury trends and developments observed over 2021. For those that missed it, the 2021 PwC Global Treasury Survey identified a number of priorities that corporate treasuries are focused on for the purpose of improving operational efficiency, reducing risk and empowering businesses to embrace sustainable change.

Business partnering, raising digital acumen, driving ESG, optimising cash and reducing financial risk were the top five priorities identified to the future of treasury. Digitisation was the underlying theme to these areas of opportunity, given its increasing requirement to meet customer demands and improve the timeliness and accuracy of reporting. The pandemic has accelerated demand for technological advancement, as it increased reliance on e-commerce and digital security. This was also fuelled by an urgent need to ensure visibility of cash and liquidity, as well as execute daily treasury tasks from home and within adequate controls and company policies.

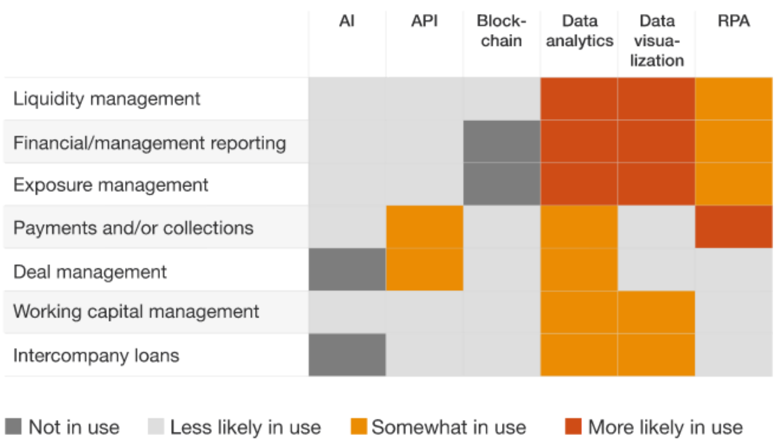
Entering partnerships are key to strengthening relationships with businesses, with 44% of respondents saying this is a hot topic for their CFOs. Considerable focus was given to the role technology plays in driving these relationships, with 69% of respondents reporting technological affinity as a key competency for treasurers of the future. Inaccurate forecasting and cash visibility remains the top challenge facing treasury teams, with forecasting being the most manual task. The accuracy and efficiency of forecasting, particularly in terms of providing businesses with economic insights, hinges on a business' ability to embrace technology within the fabric of the organisation.

CFOs and treasurers ranked technology and digital innovation equally in this year's list of priorities, scoring significantly higher than the prior survey (2019). Treasury industry standards have shifted in the direction of robotic process automation (RPA), application programme interfaces (API), data analytics and visualisation tools in order to meet future conditions. Technology is expected to aid the void in financial risk management by increasing a firms' ability to develop and understand external exposures in a timely manner. A small number of clients from the global network surveyed use RPA, AI and APIs to project cash flows, currency and economic anomalies.

- Currently, data analytics and visualisation tools are driving value-add functions by improving the management of liquidity and economic exposures, along with providing financial reports.
- 90% of respondents expect APIs to become part of the treasury function over the next two to three years.
- 45% of respondents reported "lack of technology" as the key issue constraining organisation interconnectedness.

Data analytics and visualization tools embedded across corporate treasury

Q: In what area(s) of treasury do you actively use these tools/technologies?



Source: PwC Global Treasury Survey, August 16, 2021: Base 128

ESG continues to grow as a key strategic priority. The rise of green and sustainable banking initiatives has further incentivised businesses to invest with an ESG lens, which has spurred demand for ESG related treasury expertise. Treasurers can provide an ESG framework to assist businesses in making financing and investment decisions. Currently, 54% of firm's say they are not being formally guided by ESG factors in the treasury decisions they make. Only 10% of respondents say ESG is a significant factor in their excess cash investment decisions.

Recent green banking initiatives businesses may wish to pursue include:

- The introduction of new short-term ESG-related bank deposits which provide an option to responsibly invest excess cash on a short-term basis.
- Lower interest rates on sustainable loans and bond issuances may be available to businesses with ESG ratings.
- Supply chain financing (SCF) can be used to leverage sustainable production processes in order to benefit from more attractive financing, along with incentivising uptake of green supply chains.

Ensuring treasury teams are aligned with the ESG goals of an organisation is key to supporting the execution and success as consumers and customers become more attuned to their impact. Treasurers should work closely with supply chain teams to encourage green financing for risk management purposes as banks become more cognisant of the risks associated with businesses reluctant to change.

Finding optimal cash management strategies remains near the top of both treasurers and CFOs priority list in comparison to the previous survey. Optimising cash with the aid of new technology is essential in enabling corporates to rationalise banking dependence. A continual improvement in technology will support this centralised theme that requires collaboration with the broader organisation.

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The challenge of forecasting - the delta/omicron factor

Forecasting can be challenging at the best of times, but the arrival of COVID-19 (especially the delta & omicron variants) has made that challenge even more difficult for many. COVID-19 restrictions have dampened demand, caused shipping delays and limited the ability to employ staff. In an environment where there is so much uncertainty, it is important that the financial models designed to forecast debt levels or foreign exchange exposures are robust and have the ability to be stress tested.

Chief Financial Officers (CFO) and Treasurers often struggle with how aggressive (or passive) they should be with their forecasts. Equally, there are questions around whether it is better to position the portfolio to appease 2-3 different forecasts, or employ one single "base case", being mindful of how they might affect the others (we prefer this option). The struggle can be compared to that of being a New Zealand Warriors supporter. How you might ask? We all have a lot of optimism at the start of each season that 'this is our year' and the Warriors will do well. However, a combination of strong opposition, brain explosions and dropped balls don't always see this eventuate. Similarly, for corporates (and councils), a number of factors can impact the actual exposure (debt or foreign exchange). For example, shipping delays have pushed out the timing of cash flows for many businesses. From a council perspective, the Three Waters reform has proved challenging as to which forecast to manage interest rate risk against.

So how can we ensure the forecasts are sensible when there is so much uncertainty and there are so many influencing factors? We outline our take on a few good practice tips when it come to forecasting below:

1) Automation

It is important to ensure that whatever tools you are using to forecast your exposures are robust enough to deliver fast and accurate results. Whether you are using excel or any other application to undertake your forecasting, it's recommended to learn the features of the application in order to help automate the data flow through the model to generate your forecast. It is also important to structure the model in a way that is easy to understand and use.

2) Look at past performance

Whilst any investment advisor will be quick to tell you that past results are not an indication of future performance, existing trends, seasonality and patterns can be a strong indicator of future performance and should be considered in the forecasting process. If nothing else, it’s a place to start.

3) Control what you can

While controlling (and having visibility of) the timing of payments is relatively straightforward, getting receipts in the door can be hard. Ultimately, there is only so much you can do, but there are smaller, more micro changes such as adjusting the structure of your payment terms, offering payment options, tweaking the details and data you provide on invoices that can help improve the timing and predictability of receipts. These little things are in your control and could be investigated to see if it would help improve the accuracy of forecasting over time.

4) Be realistic

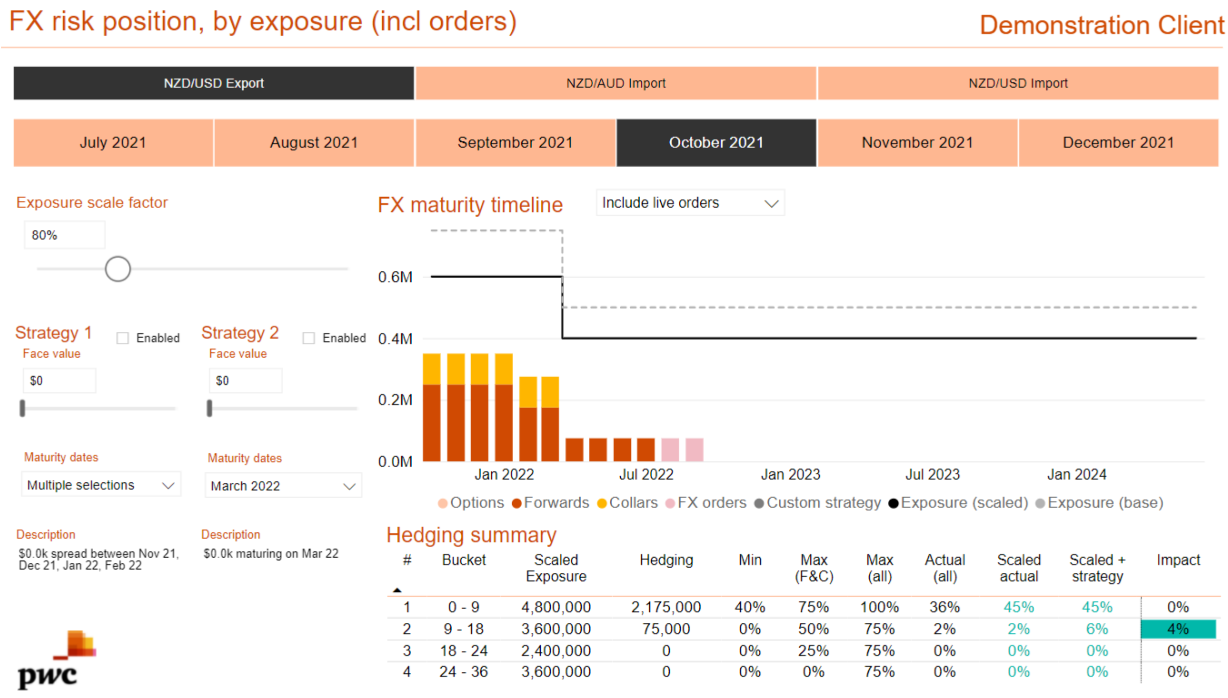
In order to be of any use, a forecast should be sensible and reflect reality. History may be a good place to start but will be unreliable in disrupted times. In an uncertain economic outlook the business will be impacted in different ways in terms of magnitude and time period of impact. It is vital that assumptions be realistic and not sugar-coated. Realistic assumptions are best achieved through the finance team engaging actively with the wider business to best understand how sales, costs, debtor and creditor ledgers contribute to drive the underlying cash assumptions.

5) Avoid too many details

More details and inputs to a forecast model doesn’t always correlate with accuracy. An overly slimmed down approach can be equally problematic. Excess detail can cause an overload of information, which will likely result in more errors in the model and slowdown the process. However, a lack of detail can lead to miscalculations and material errors. Our view is that a business generally has more visibility of cash flows in the short term and therefore believe the plan is to have more detail in the short-term and less detail further out.

6) Consider what-if scenarios

This point is extremely important, especially in a delta, omicron (or highly fluid) environment. Uncertainty brings volatility in actuals against forecasts, providing a challenge for treasurers when making hedging decisions. To avoid a situation where the business becomes over hedged, it is important to build *what if* scenarios into the model to stress test the forecast and its impact on compliance to the risk management policy parameters. The PwC Treasury Intelligence tool provides this functionality, allowing for various debt forecast scenario inputs (in the interest rate module) and also allowing scaling of foreign exchange exposures (in the FX module). These inputs then flow through the model to provide the impact on the hedging position relative to policy parameters. See an example of the FX module exposure stress testing outputs below:



In summary, as challenging as forecasting is in a pandemic environment, we believe that having a robust, automated model with realistic inputs will put you in the best position to generate a sensible forecast. However, forecasts are never perfect and therefore building in what-if scenarios will provide greater insight when looking at hedging decisions for foreign exchange or debt exposures.

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The importance of understanding your credit profile

Following 2020, a year of elevated liquidity concerns, we'd conclude that 2021 was a year where organisations thought more strategically about the broader mix of funding and if it was right for 'the now' as well as into the future.

Whether it's thinking through the capital structure of a business, your debt capacity, considering bank lender pricing and terms or intra-group borrowing rates, having a better understanding of your organisation's credit profile enhances capital and financing decisions being made. We have observed that understanding the business' credit profile supports robust discussions with the Board, stakeholders and with lenders.

An understanding of the key credit metrics will inform key policies and conversations with the Board particularly around business growth and capital expenditure plans. Formalising the "target" credit profile in the Statement of Intent, financial strategy or within the objectives set out in the Treasury Policy will provide a structure and framework within which capital and debt strategy decisions can be made. Our expectation is that these metrics support the underlying framework and risk profile of the organisation and are reported on a current and forecast basis.

Recognised credit methodologies and metrics that focus on funds from operations to debt, and interest coverage ratios can be applied and considered within a credit rating targeting approach such as an investment grade standing. Care should be taken to understand that this approach is not a formal credit rating given the broad range of qualitative and quantitative measures that a full credit rating process would evaluate but this process provides credit profiling guidance.

We have observed situations where a greater understanding of an organisation's financial and credit strengths and weaknesses, and their targeted credit profile increases clarity in decision-making such as;

- Where an organisation has a large capital expenditure programme over a number of years, management and the Board can evaluate the impact on its target metrics and amend or adjust the programme to suit and/or accept that their targeted credit profile may be compromised for a period of time. Solutions such as deferring some of the capital spend or deferring dividends could be made.

- Understanding the total debt capacity within the credit profiling objectives can assist in determining how best to use that capacity. How much is utilised for current and forecast core and working capital borrowing, liquidity buffer amounts and debt cures from risk events that may impact the business.

- Intra-group borrowing arrangements and what pricing and terms are appropriate given the credit profile of the subsidiary. What is a reasonable and justifiable credit margin to charge. The credit profiling can also govern the metrics to support the ongoing concern nature of the business.

- Informing of lender RFP processes and negotiations leading to Information Memorandums that best articulate the organisation's credit, strengthen the RFP document and process whilst optimising the pricing and terms received from bank lenders. Differences in bank pricing and terms can be better understood between the parties also.

- Providing comfort to stakeholders, shareholders and lenders that the business plan or financial strategy is achievable within a sustainable financial framework.

Understanding and targeting your organisations' relevant financial and credit metrics is an approach consistent with those lenders undertake when evaluating the credit standing of a business. One way of starting the process is to collate your bank's key metrics and understand what credit standing they assess for your organisation.

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Funding priorities: 'Nice to have' vs 'Need to have' when reviewing documentation

'Nice to have' versus 'need to have' is an ongoing question of balance and perspective relative to the environment at-hand. We find this question is particularly relevant when seeking to refresh how a financial relationship is defined through [loan] documentation terms & conditions between a bank and its customer (usually as a borrower).

As is often the case, a simple ‘reprint' of an existing relationship’s terms and conditions does not recognise the changing commercial nature of markets, the intervening movements in what now represents ‘best market practise’, or recognise changes in the customer’s business model.

We are not talking about fundamental shifts in covenants, representation or warranties - although periodic comparative analysis of these relative to your peer groups is warranted. Smaller (or subtle) changes to terms and conditions that define the relationship also warrant review. We continually encourage our clients' bankers to ask the question of themselves internally: do we actually need those specific terms that define and fashion our relationship & support of that customer, or would something more targeted and viewed as a market norm be acceptable here?

Examples of questions from the client perspective include:

- Are my bank reporting obligations appropriate?
- Am I able to actively manage my cost of funds between banks?
- Can I drag-along the bank's decision making.process?
- How do I define debt, and how transparent is my bank's cost of funding?

Freeing up information and reporting time for management, streamlining bank decision making processes and reducing business operating risk are just some of the examples of shifts that can occur with a bank/customer relationship which are collectively acceptable to both parties.

Whilst the financing market remains competitive, it is also based on a lot of precedent and a documentation mantra of one-size-fits-all. As client-side debt advisers we continue to prompt market participants on the ‘need’ versus the ‘want’, to ensure that documentation of our clients relationship with their banker is balanced, relative and on-market in order to achieve the stated purpose and ultimately the strategic priorities that underpin it.

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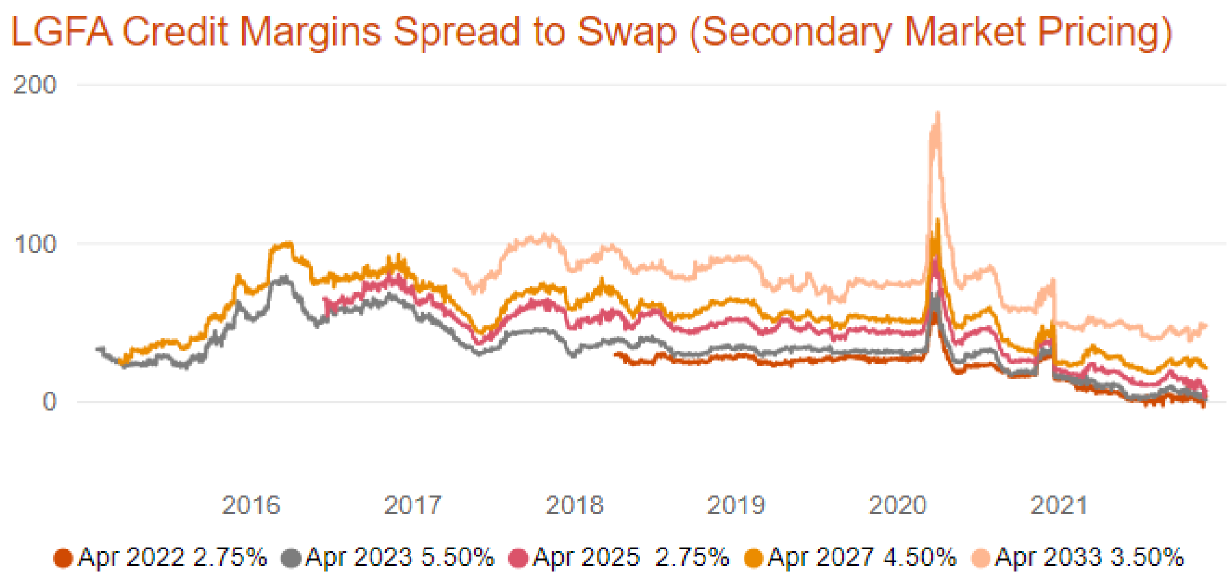
Council considerations for pre-funding

Recent movements in the New Zealand interest rate curve and increases in term deposit rates, considered alongside low LGFA margins, have improved the attractiveness of pre-funding maturing core debt. In order for the pre-funding activity to be beneficial the term deposit rate should be greater than the 90 day BKBM rate and the credit margin together.

The arrival of COVID-19 in New Zealand on 28 February 2020 and the ensuing lockdown resulted in a dramatic change in domestic interest rate conditions as the Reserve Bank of New Zealand (RBNZ) unexpectedly cut the Official Cash Rate (OCR) by 75bps to bring the OCR to 0.25%. As a result, we saw term deposit rates decrease significantly. On the other hand, the heightened uncertainty resulted in investors becoming increasingly risk averse and shifting funds to safe haven assets (such as US treasury bonds). This impacted LGFA credit margins increasing sharply due to the flight to quality and liquidity. The combined impact of increasing margins and decreasing term deposit rates influenced the appetite for pre-funding.

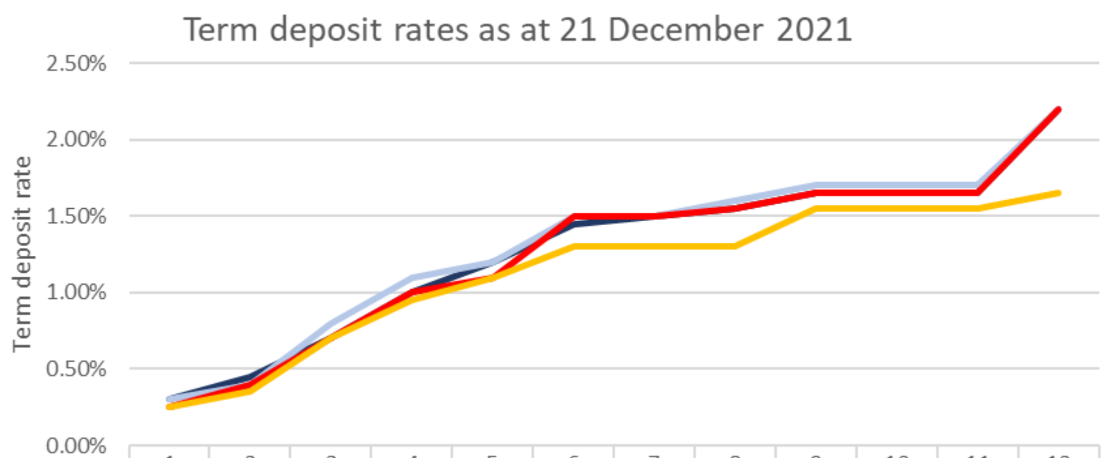
This pressure was alleviated somewhat as the RBNZ stepped in and announced that they would be expanding their large scale asset purchase programme (LSAP) to include LGFA bonds. As a result, we saw margins gradually return to pre-pandemic levels. Had the RBNZ not intervened, we would have likely seen LGFA margins remain at elevated levels.

LGFA credit margins have moved more or less across the page in the short end of the LGFA funding curve over 2021. However, the long end of the curve has trended slightly higher. We have seen the spread between shorter dated and longer dated credit margins increase, resulting in a slightly steeper LGFA funding curve (refer chart below).



We recognise that, for many Councils, over time the percentage of debt maturing in the 0-3 year time period increases. By pre-funding upcoming debt maturities in advance, Councils will be able to lengthen the term of their debt portfolio to better ensure a spread of debt maturities.

To benefit from raising the new debt early (and paying the interest costs) the term deposit needs to be greater than the 90 day BKBM rate and the margin. See indicative term deposit pricing from the four Australasian banks below, as at 21 December 2021:



	1	2	3	4	5	6	7	8	9	10	11	12
BNZ	0.30%	0.45%	0.70%	1.00%	1.20%	1.45%	1.50%	1.55%	1.65%	1.65%	1.65%	2.20%
ANZ	0.30%	0.40%	0.80%	1.10%	1.20%	1.50%	1.50%	1.60%	1.70%	1.70%	1.70%	2.20%
Westpac	0.25%	0.40%	0.70%	1.00%	1.10%	1.50%	1.50%	1.55%	1.65%	1.65%	1.65%	2.20%
ASB	0.25%	0.35%	0.70%	0.95%	1.10%	1.30%	1.30%	1.30%	1.55%	1.55%	1.55%	1.65%

Month

BNZ ANZ Westpac ASB

Given the normal deposit curve (interest rates increasing as a function of time), the earlier pre-funding is transacted the better is the opportunity for positive term deposit rates and carrying value.

Pre-funding is not a one-size-fits-all scenario. We encourage those with thoughts, comments or queries to get in touch.

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Treasury reporting - two years on, the struggle is still real

Rolling back the clock to 2019 - the PwC Global Treasury Survey highlighted the struggles organisations face with regards to reporting. Concerns that were highlighted in the survey included 1) the struggle faced in producing treasury reports that offer genuine insight, 2) human error when working in spreadsheets (or similar), and 3) differing needs between small, medium and large organisations. Jumping forward to the present day, and the 2021 PwC Global Treasury Survey (an overview of which is provided above), implies that among the multitude of evolving concerns faced by treasurers in 2021, reporting still remains a key challenge.

Traditionally, treasury reporting referred to monthly or quarterly Board reporting, where operations (such as cash, funding and FX management) were outlined in order to support the Board's decision-making needs. As the scope and impact of the treasury function broadens, so too does the impact and relevance of reporting. Real-time analysis and insights can serve to support management in day-to-day functions, as well as larger, ad-hoc projects. From the perspective of the Board, confidence in the quality of the data within the reports and the digestibility of the presentation of that data is becoming increasingly important. Directors may be held personally liable if they are deemed to have not adequately fulfilled their legal obligations.

Confidence comes at a cost, but that cost need not be excessive. Not every organisation is in a position to implement, or has a need for, a fully integrated treasury management and reporting system. That being said, organisations of even modest scale should not be relying upon purely Excel-based reporting in 2021. We have all seen spreadsheet code ‘break’ or formulas not copied correctly.

Treasury reporting in the 2020’s requires a digital transformation, leveraging tools such as PowerBI to provide clear visualisations, allow on-the-fly flexibility and serve as a robust, confidence-inspiring single source of truth. The reporting environment, the needs of the audience and the tools employed to meet those needs are evolving, though the core principles upon which a sound reporting framework is based are unchanged.

- **Brevity** - the use of visual representation, traffic lights, performance charts and policy compliance dashboards.
- **Clarity** - clear wording without the use of treasury and financial market jargon. Keep pages to a minimum.
- **Integrity** - reliability and accuracy of information.
- **Forward looking -** focus on the future. As it impacts the organisation, discuss the outlook for financial market conditions, projected policy compliance and treasury strategy, and what this means for forward risk mitigation.
- **Key changes** - consider significant changes to the last period’s reporting, underlying exposures and hedge positions, and whether significant transactions impacted exposure forecasts.
- **Timeliness** - reports to be distributed well before the meeting to allow Director preparation.

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