ASSOCIATION FOR FINANCIAL PROFESSIONALS

AFP TREASURY IN PRACTICE GUIDE

What's Next? A Practical Guide to Prepare for Change in 2023

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Kyriba is proud to be a continued supporter of AFP's Treasury in Practice series, including this most recent publication, What's Next? A Practical Guide to Prepare for Change in 2023.

2022 can be best described as volatile and while 2023 offers no immediate relief, there are new practices and strategies that treasury can harness to drive financial resilience.

1. Cash Forecasting – while the practice is not new, forecasting has evolved. Forecasting requires more data to manage multiple risk scenarios that deliver insights in real-time. Fortunately, technology has evolved – well beyond spreadsheets and treasury workstations – to simplify the modeling, presentation, and analytics of cash forecasting.
2. Liquidity Planning – an emerging practice, liquidity planning is about surrounding your cash forecast with internal and external data to optimize investment, borrowing and working capital decisions. As organizations are increasingly being valued on EBITDA resilience, treasury can show its value by perfecting liquidity planning.
3. Risk Management – Organizations who can protect their balance sheets, income statements and cash flow are increasingly rewarded by investors. Treasurers with the right processes and technology can quantify the impacts of risk on cash and financial statements and through data analytics can more efficiently reduce risk.
4. Real-Time Treasury – APIs are a game changing technology for treasury, as they offer the ability to connect systems, unify data and integrate new apps in real-time. As more tech platforms embrace APIs, treasury can ready itself by modernizing processes to make quicker decisions. Soon there will be intra-day investment opportunities, more widespread use cases for instant payments, and the need for quicker decisions to be made that treasury will want to be ready for.

Kyriba is a proud sponsor of the AFP Treasury in Practice series. We embrace our role in helping treasury and finance teams across the world become better informed and prepared for "next". We hope this guide helps your team increase the resilience of your treasury and finance processes.

Best regards,

Bob Stark
Global Head of Market Strategy
Kyriba

INTRODUCTION

The future is far from rosy right now. Interest rates are rising, the foreign exchange market is volatile, the war in Ukraine is ongoing, supply chains are still strained post-coronavirus pandemic, and there is a growing expectation of a coming recession. If these problems weren't enough, other changes are imminent in 2023 — the launch of FedNow, the Fed's real-time payment service; the new payment standard, ISO 20022, will become operational for cross-border payments; the SEC is planning more money market reform; and Libor will cease to exist at the end of June.

To ready for all this uncertainty, treasurers will be actively preparing to ensure their departments remain as efficient as possible. By automating where possible, treasurers will free up time that can be spent managing the changing risks in uncertain times and helping their wider organizations adapt to the new environment.

This guide highlights the main issues that will affect treasury in 2023, and identifies the key questions to ask as treasurers seek to build resilience into their organizations in the face of uncertain times.

PREPARING FOR THE FUTURE

Treasury practitioners are generally not in the business of predicting the future. Rather, their role is to anticipate future scenarios, identify potential exposures, and then protect their organization's assets by managing those exposures. To illustrate the point, there is a broad consensus that the Fed will continue to raise core interest rates throughout 2023. Treasury's role is to understand the implications for their organizations if that happens, but also to protect their positions if the Fed defies expectations. In other words, while interest rates are likely to continue to increase, an unforeseen series of events could result in a reversal, and treasurers have to protect their organizations against all eventualities, not just the most likely.

Even so, there are some events that will continue to influence the business environment in 2023 and that treasurers — and their FP&A colleagues — should build into their scenario analyses as they seek to manage risk.

THE GLOBAL ECONOMY IN 2023

The business environment is framed by the state of the wider economy. The decisions by central banks globally to tighten monetary policy are likely to have some significant consequences for businesses. There is already disruption in the money markets as interest rates rise around the world, and investors hold on to cash for fear of missing out on future higher returns. This might turn into a longer recession if central banks, including the Fed, overtighten monetary policy by raising interest rates too high as they seek to keep a cap on the various inflationary pressures.

Market volatility and uncertainty mean that financial risks are evolving. First, company strategists are alert to a potential recession and are trying to find ways to build resilience into their planning. For many companies, this process starts with the balance sheet, whether by drawing down additional cash to act as a buffer and then identifying how best to manage that cash in a safe and liquid manner, or by paying down debt where possible to reduce interest expense.

Second, we are all getting used to operating in a changed interest rate environment. As interest rates rise, risk is priced differently and some companies (and financial institutions) that have operated successfully on low interest rates may begin to struggle as the environment gets tougher, borrowing costs increase and cash flows become more difficult to manage.

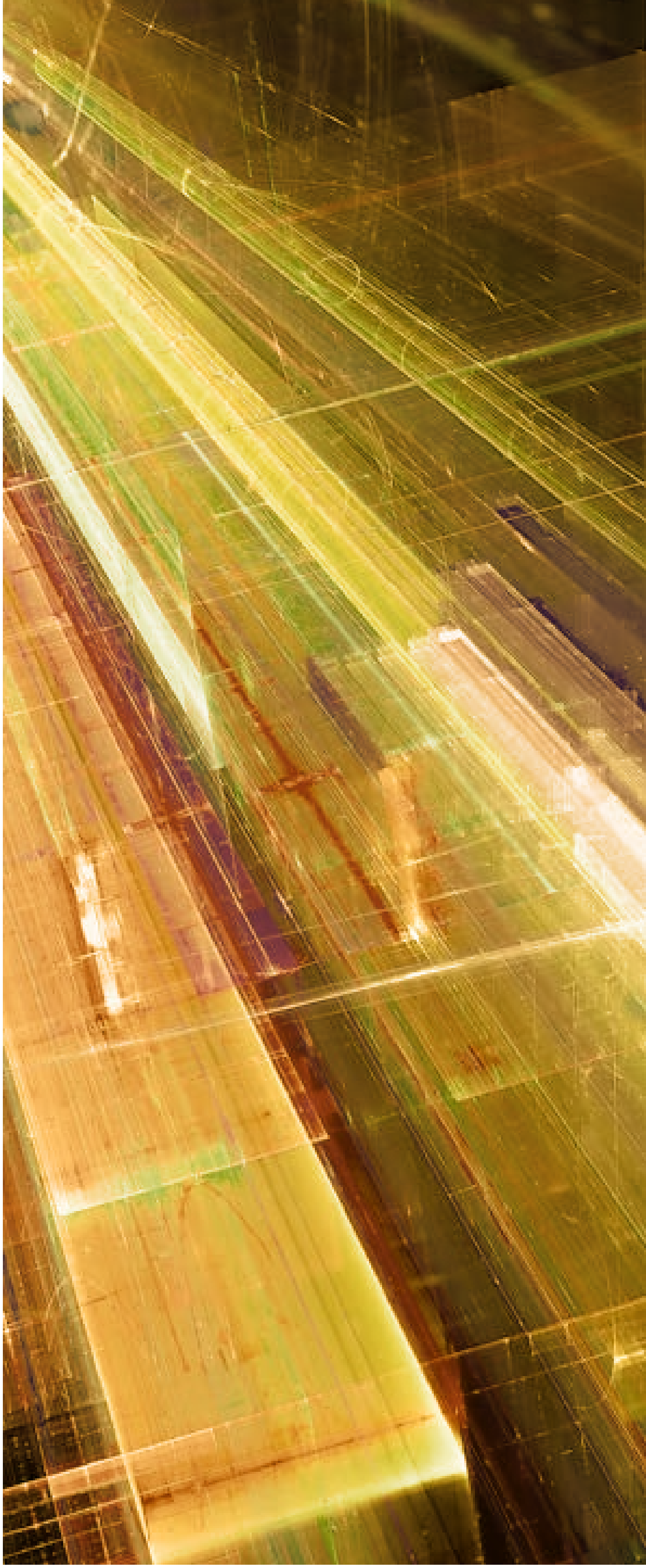
Third, there has been disruption in the foreign exchange market too. The macro story is one of appreciation of the U.S. dollar in 2022, overlaying a period of more general volatility as the market responds to different triggers.

Fourth, there are many geopolitical factors in play. These range from the ongoing war in Ukraine, to heightened tensions in the South China Sea, to the residual impact of the pandemic.

SPECIFIC CHALLENGES FOR TREASURY

Each of these factors facing the global economy will have company-specific implications for every treasury practitioner. Every company operates within its own set of circumstances, and some will be more recession-proof than others. Companies operating internationally will face different challenges in each of the territories where they have a presence. Generally, as they plan for 2023, treasury practitioners will be focused on a series of challenges including:

- **Boosting resilience.** It will be treasurers, working with the wider finance teams, who will have to manage the company balance sheet. The aim will be to ensure the company has access to sufficient cash at all times, irrespective of the state of the economy. There may be fundraising implications, as well as the responsibility to manage the investment of cash.
- **Managing counterparty risk.** Customers and suppliers will all react to changing interest and foreign exchange rates in different ways. Most will be able to achieve a degree of resilience; some will not and consequently will have difficulties. Treasurers will use the skills and understanding of their businesses honed during the height of the pandemic to focus on managing cash flow and trying to strengthen the wider supply chain.
- **Protecting the budget.** Volatile prices, from inflation and changing exchange rates, can wreak havoc on a company's budget. One of treasury's core tasks is to manage any financial risks to protect the budget, particularly with respect to cash flow.
- **Expecting the unexpected.** The hardest part of treasury's role is to prepare for unforeseeable events, whether that is a sudden reversal in interest rate movements, the impact of supply chain problems or another black swan event.



KEY TREASURY THEMES FOR 2023

While the headlines focus on the issues causing uncertainty in 2023, treasurers can target three objectives to maintain resilience in these uncertain times.

ACHIEVING EFFICIENCY

Improving efficiency is a constant focus, as treasurers continue to be asked to "do more with less." During times of uncertainty the rewards from an efficiency improvement are elevated as more time becomes available to devote to recognizing, understanding and managing risk.

Achieving efficiency is generally an incremental process, in which departments become more efficient over time by automating where possible and adopting new workflows to overcome particular pain points and reduce operational costs. In addition, a large treasury transformation project, such as the implementation of a new treasury management system (TMS), offers the opportunity to make significant efficiency gains all at once.

There are always new opportunities to become more efficient. The task for treasurers is to identify the best way to implement them so that future opportunities can be more easily realized. Following are some opportunities you can execute now.

- **Is the department getting the best value from its banks/vendors?** It is good practice to review bank fees on a regular basis. It helps to make sure banks are not overcharging, but also can identify tasks (e.g., payment processing) that can be managed more efficiently. Other costs can be reviewed too; for example, it can be possible to negotiate lower card acquisition costs.
- **What additional tasks can be automated?** It is similarly good practice to regularly review all existing treasury processes to identify bottlenecks and unnecessary manual intervention. Automation helps to manage operational risk, by reducing the incidence of error and fraud. Automating processes will release departmental time that can be devoted to more strategic activities and allow decisions to be made based on more accurate and timely information.
- **Can treasury improve its use of technology?** One way to automate more activities is to broaden the use of existing solutions, such as the TMS, by implementing unused features. As an example, a company may use its TMS to manage its bank account activity, but still run its cash forecast on a spreadsheet. While there may be an additional cost to utilizing additional elements of a TMS, this may be outweighed by the improved efficiency and accuracy of the automated forecast, especially if the improved forecast can be used to manage liquidity more efficiently.
- **How does treasury technology link with internal and external partners?** Managing connectivity can be both time-consuming and costly, depending on the structure of departmental technology. Implementing APIs can be more efficient by simplifying connections between different systems.

For companies with a small number of key customer accounts, monitoring individual DSO levels will also highlight potential problems with key customers and allow early intervention to take place.

MAINTAINING LIQUIDITY

As part of the challenge to build resilience, treasurers will be identifying ways to maintain and improve their organization's access to liquidity. There are three broad areas where improvements can be made, which the following questions will help you explore.

- **Can treasury manage internal liquidity more effectively?** Improving visibility of cash and enhancing the quality of cash forecasts allow treasurers to make more informed decisions on the levels of cash to hold; streamlining the use of cash, such as through automated sweeps to cash pools, ensures any cash is used to its maximum efficiency. Implementing an in-house bank structure can help to achieve both these goals.
- **How will treasury maintain liquidity as interest rates rise?** Some companies will look to pay down debt to reduce interest expenses. Others will draw down more cash to ensure liquidity should the market tighten, but will then need to manage that additional cash, perhaps by investing out along the curve once rates start to stabilize, again to potentially increase the yield on short-term cash.
- **What opportunities are there to manage working capital more efficiently?** With the threat of recession, companies have to be mindful of potential impacts along their supply chains. Monitoring general DSO levels will give warning on potential deterioration in incoming cash flow, allowing treasury to manage any associated liquidity risks. For companies with a small number of key customer accounts, monitoring individual DSO levels will also highlight potential problems with key customers and allow early intervention to take place. There may be opportunities to manage the cash conversion cycle more effectively, e.g., by paying suppliers later and accelerating cash collections. Keep in mind though that while accelerating the receipt of cash may be beneficial to one particular company, it may have adverse consequences for the supply chain as a whole.

MANAGING VULNERABILITIES

Taking action to improve efficiency and maintain liquidity will make the company more resilient in the face of unforeseen events. Treasury should also work on identifying potential vulnerabilities by answering three core questions:

1. **How exposed is the business to changing market conditions?** Much of the focus has been on rising interest rates; however, the foreign exchange and international commodity (notably oil and gas) markets are also volatile. One way to assess vulnerabilities is to run a series of scenario analyses, modeling outcomes in different combinations of market conditions. This process will help treasurers understand how exposed their organizations are to, for example, further increases in interest rates. With this information, treasurers can plan how best to protect against each particular risk, both in the short term and further into the future. Having an effective financial risk management policy covering all financial risks, together with management support to act when appropriate, reflects a prudent best practice. Failure to make adequate preparations may result in higher costs of doing business, ultimately reducing both revenues and profits.

2. **How can treasury become a more effective partner to the rest of the business to help identify and reduce vulnerabilities within the organization?** With a deep understanding of both cash flows and risk, treasury has a good knowledge of how the wider business operates and how sensitive each part of the business is to changing market situations. By freeing up time through automation, treasury can support different business units to understand how market conditions, such as rising interest rates or changing exchange rates, can affect their operations. For example, when working with procurement, treasury can show how the supply chain can become more vulnerable as energy prices rise. Stronger companies may be in a position to support their suppliers via the implementation of a supply chain finance solution. On the sales side, treasury can help accounts receivable understand any threat to cash receipts and, for international sales, provide advice on the use of letters of credit. By engaging with the business as decisions are being made, treasury can help the company adopt solutions that will improve the management of working capital and liquidity, and identify and manage risk more effectively, collectively reducing exposure to external market volatility.

3. **Is the business prepared for planned market changes in 2023?** There are some important changes that will feed through to corporate treasurers at various points during 2023. The Fed's real-time payment system, FedNow, will launch and the process of transitioning away from Libor will be completed at the end of June. The SEC is also expected to introduce some reforms to 2a-7 money market funds, although the details have not yet been finalized. The implications of these changes are discussed in the next section.

ISSUES TO MANAGE IN 2023

This section explores four key developments that will impact treasury management in 2023 and outlines how treasurers can take full advantage of the opportunities they provide.

REAL-TIME PAYMENTS IN THE U.S.

The Fed's real-time payment system, FedNow, is due to come online in 2023. It is not the first real-time payment system in the U.S., as The Clearing House's RTP® network came online in 2017, and internationally, the ability to make real-time payments has been around for a number of years. However, it is likely that the introduction of FedNow will increase the uptake of real-time payments in the U.S., not least because it will extend the availability of real-time payment functionality to more banks.

From a treasurer's perspective, the key is to determine whether greater availability of real-time payments represents an opportunity to improve efficiency or an added vulnerability to be managed. The answer, at least initially, will vary between companies and will depend on whether they have a business case to extend their use of real-time payments. Broadly, there are some very specific use cases that encourage the use of real-time payments. For example, it may be necessary to make emergency payments to suppliers or customers when an initial ACH payment fails, and a real-time payment will be much more cost-effective than a more traditional wire. Real-time payments will also be an efficient way of making payments to casual labor outside of traditional banking hours. On the collections side, any payment linked to an instantly available good or service, such as a pay-per-view sporting event, will be irrevocable if collected by real-time payment instead of credit card. Over time, increasing numbers of companies will add real-time payments alongside more traditional payment types.

As well as being continuously available, real-time payments have two key features — irrevocability and instant processing — that will alter the risk profile of payments management within the treasury department. It is therefore important that treasurers understand the implications of real-time payments, especially for liquidity and operational risk management, by asking a series of questions, including:

- Will banks be able to provide real-time information to feed into internal systems? Again, to obtain full benefit of real-time payments, such as to manage liquidity on an intraday basis, banks need to be able to provide data to their clients in real time.

- If real-time data feeds are available, how can the company access them? Most banks offer APIs to manage the flow of data with their clients; however, for companies with multiple banks, managing multiple API connections can be time-consuming, adding cost to any project.
- Will internal systems and processes need to be adapted to manage real-time payments? To provide maximum benefit, systems will need to capture and process data in real time. In addition, any use of real-time payments for disbursements will need to have operational controls embedded as, once initiated, real-time payments cannot be recalled.
- If real-time payments are linked to another business process (e.g., the release of a shipment on receipt of payment), how will the linked business operation access the real-time data relating to the payment (e.g., how will logistics know when payment is received so a shipment can be released) or respond to a request for payment received outside regular business hours? Companies may be able to create a competitive advantage if they can react faster than their competitors to the receipt of a real-time payment.
- How will banks apply cut-off times for balance purposes? Their approach will affect how the timing of received and outgoing payments impacts earnings credit, for example.

ISO 20022 – IMPROVEMENTS TO CROSS-BORDER PAYMENTS

In March 2023 (delayed from the planned November 2022 launch), ISO 20022, the new payment messaging standard goes live for cross-border payments. Over the three years following the launch, most central banks around the world expect to transition their real-time gross settlement (RTGS) systems (such as Fedwire) away from existing payment messaging standards and over to new ISO 20022 xml-based messages, which are, for payments, pain and camt message types. For all users, the potential benefits derive from the ability of new message types to carry more data along with payment or account information. Once fully operational, treasurers should be able to identify significant benefits of the transition. Cross-border payments should be more transparent because of interoperable standards offering more structured data. The same data will ease the automation of

Companies may be able to create a competitive advantage if they can react faster than their competitors to the receipt of a real-time payment.

more of the disbursement and collection processes including reconciliation. In turn, these improvements to payment processing will lead to a more efficient use of liquidity.

While the timing of the transition will vary by country, by acting now, treasurers can ensure their ability to take advantage of the new format as soon as possible. Here is what treasurers will want to review:

- **How will treasury send data to their banks?** With the changeover in message standards, some file formats will not be supported in the future. It is important to discuss transition plans with banks and other payment service providers. For the time being, TMS and ERP providers will still be able to process hybrid formats (e.g., BAI, XML, and JSON, which is used by many APIs) as they are used to manipulate multiple file formats.
- **How will treasury hold data and access data held by other internal departments?** Treasurers will want to work with their TMS and ERP providers to ensure any static data (e.g., data held on suppliers) is updated to be compatible with any new requirements. Failure to do so may not prevent payments from being processed, at least initially; however, it is likely to mean payment processing is less efficient than it could be as all the remittance information may not be available.
- **How will treasury capture bank data?** The new formats will hold much more data alongside standard payment information. Being able to capture that in the TMS and/or ERP will provide much wider benefits than improvements to transaction reconciliation. For example, the enriched data could be used by an AI-based cash forecast to develop more accurate forecasts, allowing treasury to streamline the use of liquidity.

MONEY FUND REFORM

Following significant redemptions from prime money funds in spring 2020, the SEC has proposed a series of reforms aimed at improving the resilience of the sector. Although the proposed reforms had not been finalized at the time of writing (November 2022), the proposed introduction of swing pricing for institutional prime and tax-exempt funds would encourage a further switch from prime to government and treasury funds. As proposed, a fund that has net redemptions over a specific time period will be required to amend its net asset value for that period. Assuming the SEC adopts swing pricing in its final proposals, treasurers will need to review their use of money funds, as there will be an increased risk of a loss of principal when investing in affected funds.

Most treasurers review their investment policies at least annually and evaluating the impact of money market reform will only be one part of that. More generally, treasurers will address the following questions when reviewing their investment policies (or setting one up, if their company does not already have one in place):

- How does the policy currently bucket cash (e.g., between operational/working capital cash, and other buckets)? Do these buckets need to be adjusted (e.g., a larger proportion of cash could be bucketed, and therefore invested, as operational cash), given the threat of recession and the rising interest rate environment?
- If the SEC introduces further money fund reform, how will the reforms affect the risk profile of the funds in which the company is invested? Notably, how do the reforms affect the safety and liquidity of any cash invested in affected funds?
- Should the company consider other investment strategies or investments, especially if it chooses to hold more cash on the balance sheet to protect against the threat of recession? For example, for non-operational cash, treasurers will look at strategies to generate an enhanced yield (reflecting the opportunity cost of holding additional cash). These may include shortening portfolio duration while interest rates are still rising and/or considering investing in non-investment grade instruments.
- How does volatility in the foreign exchange and commodity markets influence the short-term investment policy?

THE END OF LIBOR

Although most Libor settings ceased publication at the end of 2021, five USD Libor settings (and six synthetic settings in GBP and JPY) will continue to be published until the end of June 2023. Little new Libor business should have been written since the 2021 cut-off date, but there will still be some legacy USD Libor business to be managed, including remaining syndicated loans, term loans and intercompany loans. The amount of USD Libor outstanding by June 2023 has been estimated at $74 trillion.

Most companies have started to transition away from Libor, not least by agreeing to use a new rate, such as SOFR, for any new business. While some contracts will mature before the end of June 2023, many organizations will still have outstanding legacy agreements to transition. For those who have yet to start transitioning, it is time to prepare, as external support may not be available closer to the deadline. Outstanding business can be divided into two parts: contracts agreed with partners, typically banks, and arrangements organized internally, typically intercompany loans. Both require an understanding of current exposures including all contracts that will be live after the end of June 2023.

For external business, there are some key questions to ask of banks and other relevant partners:

- For each contract, which reference rate will apply, how will interest be calculated, and when will interest be payable?
- Is fallback language in place where necessary, e.g., for syndicated loans? The ARRC has published a series of best practices (https://www.newyorkfed.org/arrc/index.html).

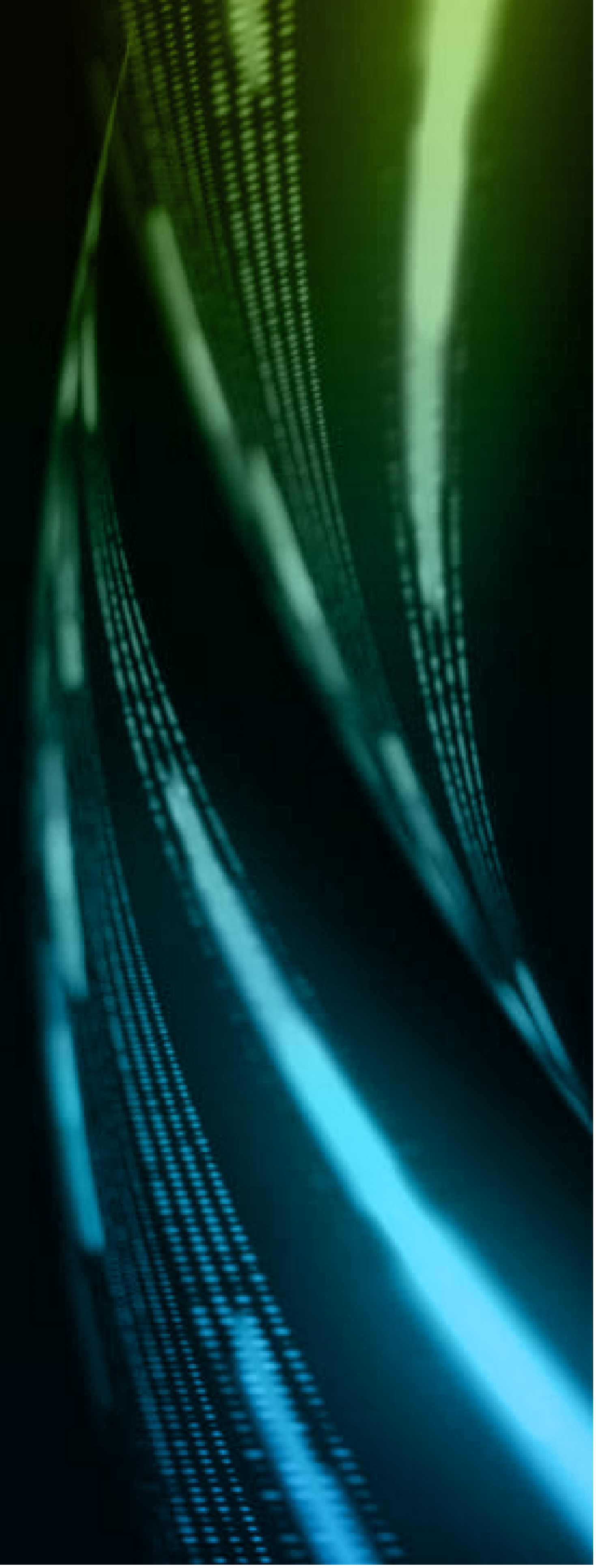
In addition, companies will have to amend any internal operations including:

- Does the company's TMS provide the ability to calculate interest and value instruments using the new rate(s), whether via the upgrade of an existing solution or the adoption of a new one?
- How and when will any intercompany loans be transitioned to a new reference rate?
- Do the company's interest rate risk management policy and procedures need to be updated?

CONCLUSION

Any changing environment offers both opportunities and threats to all organizations. The combination of volatile market environments and the impact of some significant market changes means 2023 will be interesting for corporate treasurers.

Changes in the payments space, via more real-time payments and the adoption of ISO 20022, mean there are major opportunities for treasurers to press forward with automation, based on access to more data in real time. Automation should lead to decisions based on more timely and reliable information, allowing treasurers to use liquidity more efficiently. Innovations that improve operational efficiency and the use of liquidity will also make organizations stronger and better able to withstand the threats of recession and supply chain problems.



TAKEAWAYS

By any measure, 2023 is shaping up to be a challenging year for businesses both in the U.S. and across the world. Markets remain volatile. Interest rates are expected to continue to increase, although the timing and level of the final increases remain uncertain. FX rates and commodity prices continue to experience heightened volatility, driven by the threat of recession and ongoing supply chain problems. Beneath these headlines, the treasurer's environment continues to evolve, not least due to the effect of ongoing innovation — FedNow is set to launch in the U.S. and ISO 20022 will provide opportunities to streamline cross-border payments and associated data processing.

To help reduce their organizations' vulnerabilities to the various external threats, treasurers can take action to achieve three objectives:

- **Achieve efficiency.** The more a company can automate treasury tasks, the more accurate and timely forecasts and positions will be, allowing better decisions to be made. At a time when companies' working capital and liquidity will be under pressure, all efficiency gains will help build operational resilience.
- **Maintain liquidity.** Adopting strategies to streamline the use of liquidity internally (e.g., by better use of pooling opportunities or via the introduction of a virtual account network) will reduce net borrowing requirements, protecting the company against the adverse effect of rising interest rates. Managing working capital more effectively, potentially in partnership with key suppliers and/or customers, can help to manage risk, thereby reducing costs to boost sales and profitability. Investing surplus cash appropriately, using a bucketing strategy where relevant, will help to ensure cash remains available to the business when needed.
- **Manage vulnerabilities.** A clear financial risk management policy, endorsed by management, will help to manage the effects of market volatility and limit the impact on business costs. Treasurers can work with the wider business to adopt strategies that will enhance the use of working capital and liquidity (e.g., via a supply chain finance solution) in a way that will strengthen the supply chain as a whole. Finally, treasurers will also want to prepare for coming market changes including the introduction of FedNow and ISO 20022, possible money market reform, and the end of USD Libor.

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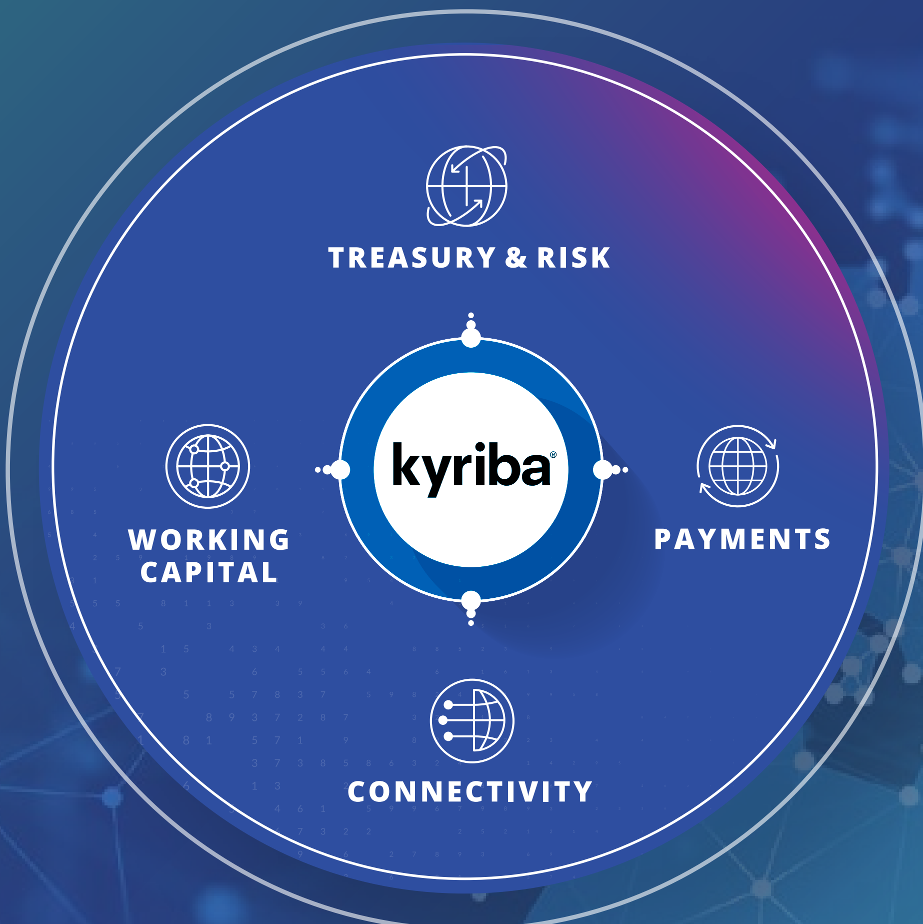

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