Treasury Trends

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Ensuring your Treasury Policy is Fit for Purpose

What is a Treasury Policy?

A treasury policy establishes the framework and guidelines for managing an organisation's treasury risks in the context of its risk objectives.

Various risks to which an organisation is exposed are identified, analysed for their materiality on the financial performance of the business, and a framework to manage the key risks is agreed, adopted and reported against.

A robust treasury policy is able to cope with most situations that the organisation finds itself in but should also be flexible enough to evolve with the organisation, and therefore be regularly reviewed.

A treasury policy is approved by the Board (or relevant governance overseer) and delegates to management the discretion to operate within defined parameters to manage risks. The policy provides comfort that key risks have been identified and are being managed appropriately, and that compliance with it is being reported.

Without a policy, decisions will become ad-hoc, there will be no clarity in managing those risks and there will be plenty of scope for management of those risks to be driven by individuals who may have strong views or opinions – but where these may also be overly influenced by near-term events.

Within the framework of the policy, market moves and prevailing prices (such as for currencies, interest rates or commodities) may lead to **different hedging strategies** and instruments being employed in order to manage the organisation's treasury risks and comply with the policy, but the **policy itself should remain unchanged.**

Treasury policy objectives should align with the organisation's objectives. If those objectives change, a policy should be reviewed and updated in line with those objectives.

The policy should also be bespoke and built solely for a particular organisation with reference to the specific risks it faces, their objectives and the organisation's appetite in managing those risks.

Key Points

- A treasury policy outlines risk objectives and establishes a framework for managing treasury risks
- It should stand the test of time
- Treasury policy objectives should align with an organisation's objectives
- A treasury policy will ensure disciplined risk management and should be bespoke
- Treasury policy coverage is evolving to succinctly capture relevant, new risks …
- … but not at the expense of ignoring existing risks.

Treasury Reflections over the last two years

While it can always be said we live in interesting times, the last two or more years have been particularly so. From a treasury risk management perspective, a shift in emphasis has also evolved across this period. In the first 12 or so months since COVID-19 broke out, emphasis was on the initial shock and its effects on uncertainty faced by businesses including in treasury related areas. In the last 6 to 12 months the implications and medium-term impacts due to COVID-19 have dominated.

The initial period was characterised by factors such as:

- Need for liquidity as revenues/receipts were curtailed abruptly in many cases while operating costs remained, requiring a number of organisations to reprioritise spending and add liquidity/standby facilities;
- Impact on foreign exchange hedging, based on immediately lower cashflow forecasts for exporters;

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- Sharply plummeting interest rates and much speculation that floating rate references (e.g. BKBM and BBSW) could turn 'negative' – creating adverse implications for organisations with interest rate swaps, where bank loan documents stipulated a zero floor on floating lending rates.

The evolution of COVID-19 related treasury management impacts over the last 12 months has also included:

- Adaption from a 'Just in Time' mentality to 'Just in Case', requiring some organisations to require greater working capital facilities, necessary to hold greater inventory levels;
- Shipping delays, supply chain disruptions and rising freight costs, with implications on cash forecasting and cash management;
- Rising interest rates earlier, and at a much quicker pace, than had initially been thought; following years of declining interest rates, organisations that have continued to implement a medium-term interest rate hedging profile have been validated with ongoing stable, lower interest costs;
- Organisations where cash is inefficiently held in separate, non-interest-bearing accounts are beginning to experience greater opportunity cost as cash/short-term deposit rates rise. Organisations relying on short-term/overnight borrowing requirements now see greater interest costs.

Treasury Policy Trends from here

What has been apparent throughout the COVID-19 period is the ever-present nature of treasury related risks. While some of these have waxed and waned in intensity, overall we would say there has been a widening of risks to manage, with liquidity, interest rates (inflation) and commodity prices leading the way.

A recent article within Eurofinance highlighted some of these evolving treasury management factors:

- *Michael Storup, a Treasurer at Inter IKEA Group, noted "We have more risks than we used to have," also explaining that the focus for his team has expanded from economic and market issues to include geopolitics. For instance, moves by western countries to repatriate supply chains from China for political reasons are helping stoke inflation adding to the disruptive impact of the COVID-19 pandemic.* Our comment; it could be argued that COVID-19 has accelerated, rather than outright re-defined, trends toward deglobalisation and the impacts of such on supply chains. More recent events around the Russian invasion of Ukraine have been another factor accentuating this movement.
- *Atul Garg, Assistant Treasurer at Campbell Soup Company, noted "If you rewind 15 months back, most companies were concerned about deflation. And a lot of companies were struggling with commodities (prices) crashing down and people were debating whether they should have a hedging programme or not."* Our comment; if a hedging policy is in place, it pays to stick to it (minimum/ maximum percentages and hedging maturity/terms can be utilised) as part of the framework of prudent risk management.
- *The post-pandemic surge in inflation has intensified the hedging debate . "Higher commodity prices, higher transport prices, higher energy prices, and the velocity of these moves in the last four or five months has put a lot of pressure on our input costs as a company," said Storup, explaining that Inter IKEA Group hedges FX, but not commodities.* Our comment; when designing policies upfront underlying analyses are required to ensure all relevant, material risks are recognised, and if warranted, managed.

Despite the growing number of risk factors impacting treasury, we are observing a trend towards more succinct policy documents. With Boards of Directors (and others) increasingly spread far and wide, what is becoming more pertinent is simple summary of actual policy statements rather than descriptive, contextual, lengthier documents. Capture and management of known and reasonably foreseen risks remain paramount, with ability to flex to changing market dynamics and environs.

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