2021 Treasury Trends: Flexibility Is Key to Overcoming Challenges

Companies will continue to face great uncertainty and volatility in 2021. Technology and strong bank relationships can help them remain flexible.

After one of the most challenging years in living memory for companies and their treasuries, 2021 is unlikely to bring significant respite. Despite hopes that an effective vaccine is now in sight, the key theme that characterized 2020 – COVID-19 and government lockdowns imposed to stem its spread – seems certain to remain dominant for part of the coming year. Other existing challenges, such as the low interest rate environment and various geopolitical challenges such as Brexit and a more assertive China, can also be expected to remain important.

Daniel Favitta
Senior Treasury
Sales Consultant
Citi Commercial Bank

COVID-19 is here to stay

According to current expert medical opinion, a widespread vaccination program of the general population is unlikely take place until mid-2021 (with healthcare and other key workers prioritized). Consequently, the 'new normal' of sporadic lockdowns, social distancing, intermittent working from home and other restrictions, is likely to remain in place for much of this year.

The relative ease with which many companies shifted to remote working, including management of complex treasury processes such as accounts receivable (AR), accounts payable (AP), audit, compliance and risk management, belies the fact that these key functions are currently being operated on a business continuity basis.

Remote working is likely to continue well into this year and some observers believe that work practices may have changed forever; it is conceivable that after a year or more out of the office, some employees will be reluctant to return. As a result, companies may need to rethink and rewrite their policies and procedures to ensure that adequate controls are in place to accommodate the additional risks that result from mission critical tasks being performed away from the office.

Some of the changes necessary to address the additional challenges and risks faced by treasury in the new normal are already underway. Most notably, there has been a significant acceleration of the move away from paper-based processes and instruments towards greater use of digital technologies. For instance, AP is increasingly moving to electronic instruments such as wires, ACH or instant payments.

AT THE BEGINNING OF 2020, THE MARKET ANTICIPATED TWO INTEREST RATE INCREASES OVER THE COURSE OF THE YEAR; IN THE EVENT, THERE WERE SIX DECREASES, TO TAKE THE FED FUNDS RATE DOWN TO JUST 0-0.25%.

Historically, there have always been some companies that have refused to accept electronic payments: during the second half of 2020 many of these companies capitulated. Even in the US and Canada, which have tended to lag Europe and Asia in the adoption of electronic payments, there is been a significant increase in their use. COVID-19 could prove to be the spur for the US and Canada to catch up with other parts of the world in terms of the digitization of AP and AR.

Technology will have a crucial role to play in ensuring that treasury remains resilient and secure even if remote working continues indefinitely. Companies should look to their banks for tools that enable them to streamline AP and AR in order to reduce processing times, lower costs, improve visibility and control, and gain access to more granular data that can improve reconciliation, by using artificial intelligence and machine learning, for instance.

Living with 0% interest rates

At the beginning of 2020, the market anticipated two interest rate increases over the course of the year; in the event, there were six decreases, to take the Fed Funds Rate down to just 0-0.25%. Similar cuts occurred in the UK while Japan and the eurozone have had negative rates for some time. Importantly, in September, the Federal Reserve indicated that it expects to hold rates at near zero for at least three more years until it sees evidence of a tight labor market and inflation is on track to moderately exceed 2% for some time – a significantly higher bar than in the past. Some observers believe negative US rates might become a reality this year.

For treasury, the low rate environment presents significant challenges when it comes to managing liquidity (which for many companies is currently plentiful, given the need for a buffer during the COVID-19 crisis). Put simply, there are now few opportunities to earn a return on funds. By mid-November 2020, the seven-day net average yield for short term treasury funds was 1 basis point (bp) while prime funds yielded just 6bp. The challenge is all the greater because treasury is usually seen as a cost center within most companies – investment returns are often used as a way to offset treasury costs.

Unfortunately, there is no magic solution given that rates are not expected to rise for the foreseeable future. Instead, companies – and treasury – must realign their yield expectations. Companies are unlikely to be willing to take additional risk in order to increase returns. Consequently, they must accept that returns are likely to be just a few basis points and instead take a holistic view of liquidity management across earnings credits, Treasury securities, time deposits, commercial paper and money market funds to ensure they achieve what scant returns are on offer and manage their risks effectively.

Moreover, treasury needs to take account of the fact that while returns on investment are meager and could continue to fall, borrowing costs will not follow the same trajectory. In most instances, banks have set floors on lending rates, so the differential between what can be earned and what must be paid in borrowing costs could well grow in the coming year.

Geopolitics remains unstable

Treasury faces a number of significant geopolitical challenges in the year to come, which could have business implications. While the outcome of the US presidential election is now clear, the consequences in terms of policy changes on trade, tax, lockdowns and social distancing and many other factors that will affect the operating environment for companies have yet to be determined.

Meanwhile, the reality of Brexit has become clearer following a last-minute agreement between the UK and the EU on trading arrangements. The UK will continue to have privileged access to the European market with tariff-free, quota-free trade in products – a crucial selling point for the UK for many US companies in recent decades. But there are new customs procedures and documentation requirements to contend with.

MOREOVER, TREASURY NEEDS TO TAKE ACCOUNT OF THE FACT THAT WHILE RETURNS ON INVESTMENT ARE MEAGER AND COULD CONTINUE TO FALL, BORROWING COSTS WILL NOT FOLLOW THE SAME TRAJECTORY.

The Brexit deal does not cover financial services; a framework for regulatory cooperation is expected by March 2021. There has been no disruption to transaction flows following the end of the transition period. Nevertheless, the many US companies that have corporate treasuries in the UK should reassess their payments, receivables and pooling structures as well as their tax arrangements to ensure they continue to meet their operational

and treasury objectives. This needs to be done on a country-by-country basis across the EU; some countries, but not all, have introduced short-term arrangements to avoid adverse tax consequences from Brexit for UK-based companies that receive interest, royalties and dividends from a company based in an EU member state.

While the US has a new president, it does not necessarily follow that there will be a significant change in the dynamic between the US and China. There is now strong bipartisan support for a tougher approach on China, although the way in which this is enacted could change as a result of the election. For instance, there could be a greater use of rules-based systems. However, it seems unlikely that tariffs will be unwound, at least in the short term.

At the same time, China has become more assertive globally, with Hong Kong effectively losing its autonomy. Many US companies have operating subsidiaries based in Hong Kong and have been monitoring events there carefully. Some are considering moving to the region's other treasury hub – Singapore – to avoid geopolitical risk. Decoupling of the US and China economies is already underway and companies have shifted parts of their supply chains away from China. However, it may prove impossible for companies to completely disengage from China given its dominance of the production of many components.

Conclusion: Flexibility is the key

Volatility seems certain to persist over both the short and medium term as a result of COVID-19 and various other international trends and developments such as Brexit. Uncertainty is likely to remain a watchword in 2021. As well as dealing with the consequences of low rates, treasury must also address the upheaval associated with the replacement of London Interbank Offered Rate (LIBOR) with Secured Overnight Financing Rate (SOFR) in the US, Euro Interbank Offered Rate (EURIBOR) in the European Union and Sterling Overnight Index Average (SONIA) in the UK, which will require considerable attention to ensure that borrowing and hedging arrangements are appropriately transitioned.

Companies will therefore need to remain nimble, both from a physical and financial operating perspective. Treasury will want to maintain tight control to ensure resilience while at the same time being flexible enough to adjust to the changing business and economic environment. Technology will be critical to this: it facilitates remote working, improves visibility, control and risk management and enables work relationships to endure. Treasury should leverage its banking relationships to the fullest extent possible, to access technology and to seek support, guidance and insights that will enable it to achieve its strategic goals in 2021.

© 2021 Citigroup Inc. Citibank, N.A. Member FDIC. Equal Credit Opportunity Lender. Citi, Citi and Arc Design and other marks used herein are service marks of Citigroup Inc. or its affiliates, used and registered throughout the world.

2008637 01/21