Managing liquidity through an economic downturn

Insights from the Global Transaction Services Advisory team at Bank of America

The fundamentals of best practice Treasury management – visibility, liquidity, security, and working capital – become even more prevalent in times of market or business disruption. Treasurers must respond quickly to support the needs of the business, as well as additional reporting to and oversight from senior management and the Board, but without compromising the control environment and rigor that forms part of their day-to-day practices. The following outlines key measures that Treasurers can deploy at speed to support the business in times of crisis.
Treasury team

**Objective:** Resourcing and staff levels are sufficient to support daily treasury operations, while maintaining authority limits and segregation of duties.

Business continuity plans (BCP)
- Specify detailed procedures for executing daily activities, such as cash management, while maintaining a strong control environment; authority limits and segregation of duty should not be compromised.
- Identify backup resources, specifically alternates who can substitute for individuals who hold primary responsibility, and periodically test execution by alternates.

Communication protocols
- Mechanism (e.g., call tree or email) for communicating BCP launch and confirming status of responsible point persons for every function.
- Consider permanent open lines for all staff to escalate to a hot room where needed.

Establish a rolling feedback loop and monitoring process for BCP execution so issues are quickly identified and addressed.

Consider the effect should BCP measures become a medium- to long-term norm, and the secondary impact this could have on staff and their wellbeing. Treasury teams need active communication of evolving market trends and the operating environment.

Cash management operations

**Objective:** Enhance cash flow forecasting
- Increase the frequency of cash flow forecasts, but apply Pareto’s Principal (i.e. the 80/20 rule) as a pragmatic approach is needed for a tangible benefit from the ongoing input required.
- Undertake a detailed review of the cash flow forecast by senior management:
  - Apply a “fresh eyes” approach to review prioritization and to actively challenge assumptions.
  - Categorize payments in terms of their ability to be postponed or deferred – ensure internal stakeholders are briefed and aligned before changes are communicated externally.
  - Classify flow by type, and where phasing can be amended or reduced, such as postponing non-critical CapEx or delaying/reducing/canceling dividends.
  - Review the funding and capital needs of subsidiaries and local operations.
- Escalate reporting of cash flow forecasting variances
  - Perform root cause analysis of variance, regardless of whether the variance is favorable or adverse.
  - Perform stress testing under various turnover scenarios to gauge sensitivity.

**Objective:** Anticipate disruption of cash management operations
- Pre-fund certain accounts to cover upcoming priority payments (e.g., payroll, tax, major suppliers, and interest payments).
  - Liaise with HR to capture any headcount changes or restructuring costs.
Review account and liquidity structures that might require temporary adjustments to ensure pre-funding remains in designated accounts – possibly suspend automated sweeps if they do not occur on a 2-way (debit/credit) basis.

Thoroughly review and test BCP for processing payments:
- Ensure remote access to Enterprise Resource Planning (ERP) and/or Treasury Management Systems (TMS).
- Confirm ability to process or authorize payments from mobile phones, via system or bank apps.
- Ensure payment authorizers, including their alternates, are fully apprised of the procedures.
- Pre-empt large payments by ensuring the CFO or other executives can access systems.

Understand the ability and procedures to stop certain payment types if necessary.

Objective: Review liquidity needs and ability to increase financial flexibility
- Review access to both committed and uncommitted bank facilities
- Seek to increase facility limits on committed working capital facilities, or to extend maturity dates.
- From the cash flow analysis performed above, defer payments where possible to buffer cash flow.
- Reduce maturity of financial investments and communicate with key credit partners on an active basis – assign specific people to individual relationships (see further detail below).

**Investments**

Objective: Focus on capital preservation
- Revisit the organizational risk appetite; capital preservation should supersede yield in challenging macro environment.

Objective: Increase liquidity
- Reduce weighted average maturity (WAM) of investment portfolios. You may consider shifting investments to overnight maturity, but consider the additional daily workload this also creates.
- Flight to quality:
  - Increase quality and liquidity of any collateral taken on investments such as on repo contracts.
  - Shift bank deposits to core relationship banks that meet credit/counterparty policy requirements.
  - Diversify any MMF investments, ensuring that investments do not exceed 5% of funds under management.
Risk management

Objective: Safeguard physical assets (e.g., cash, property, business operations)

- Analyze all corporate insurance contracts and assess ability to claim:
  - In particular, identify ability to claim under a Business Interruption clause vs an Act of God, declared government state of emergency, pandemic, or a natural disaster.

Objective: Review financial risk management policies (e.g., FX, interest, and commodities risk management)

- Confirm details of hedges/contracts and ensure alignment with hedging policy; check that level of hedge cover does not now exceed forecast foreign currency flows.
  - Consider closing out contracts or extending maturity dates.
  - Where material, notify external auditors.
  - Review ISDA provisions (e.g., right of offset, cross-default, etc).

Objective: Manage bank counterparty risks

- Increase the frequency that financial institution credit ratings, credit limits, and exposures are reviewed. Assess short- and long-term solicited international credit ratings published by the major ratings agencies.
- Monitor credit default swap spreads in assessing counterparty risk. These can provide a market-based early warning mechanism for banks experiencing liquidity issues, but focus should be on spikes rather than absolute spread.
- Establish standing calls to talk to your key banking partners on a regular basis.
- Consider intraday sweeps if concerned about monies left on accounts.
- Adjust netting cycles to be more aggressive and frequent.

Capital structure

Objective: Manage external relationships (e.g., ratings agencies, debt providers, and external auditors)

- Ensure consistent messaging from internal stakeholders
- Ensure one version of the truth is communicated in terms of financial projections – ensure clarity over reporting responsibilities
- Ensure ongoing alignment of internal stakeholders (FP&A, C-suite, Board, and Investor Relations)
- Acquisition opportunities might unfold in near-term; maintain calibration of funding capacity for M&A
- Rating agencies
  - Anticipate rating agency requests for updated schedules/data that were provided during previous rating agency reviews
- Banks
  - Test financial covenants under various cash flow stress scenarios
  - Review material adverse change (MAC), cross default clauses and grace periods
- Investors
  - Review phasing and quantum of dividends
  - Pause any share repurchase program
  - Communicate with key shareholders to assess their views and guidance
  - Synchronize all communications via investor relations as needed and appropriate
Working capital

Objective: Collaborate with internal stakeholders to ensure enhanced processes and controls over working capital

1. Accounts payable (A/P)
   - Maintain documented process controls
     - Send note to appropriate teams to underscore need to follow policy/protocols for validating and changing supplier payment instructions.
     - Confirm contact details for key suppliers.
   - Ensure appropriate timing of payment remittances in accordance with cash flow forecasting
     - Use cash forecast to drive decisions on early-payment discounts vs. exhausting length of payment terms.
     - Monitor credit default swaps and ratings of key suppliers for advance indication of potential issues.

2. Accounts receivable (A/R)
   - Collaborate with A/R to ensure timely issuance of invoices, and focus on invoicing data quality as some debtors will defer payment if key information is missing and may not advise this until the debt is due to reset the cycle.
   - Possibly adopt an 80/20 approach with significant clients, and focus on payments of high value or with counterparty concerns.
   - Monitor debtor age and escalate deviance to credit terms or standard practice.
   - Categorize customers into risk profiles based on history and credit references.
   - Increase A/R dialog with customers and escalate risks to senior management.
   - Possibly reduce credit limits for customers at risk, or consider cash on delivery for high-risk debtors.
   - Establish, document, and require senior management approval for revised processes to increase credit limits.
   - Review customers’ financial statements, such as credit ratings, liquidity clauses, borrowing covenants, head room under committed facilities, and solvency clauses.
   - For publicly rated customers, review credit rating reports for specific comments relating to gearing and solvency.
   - Review and update internal bad debt provisions and policies.

For more information

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