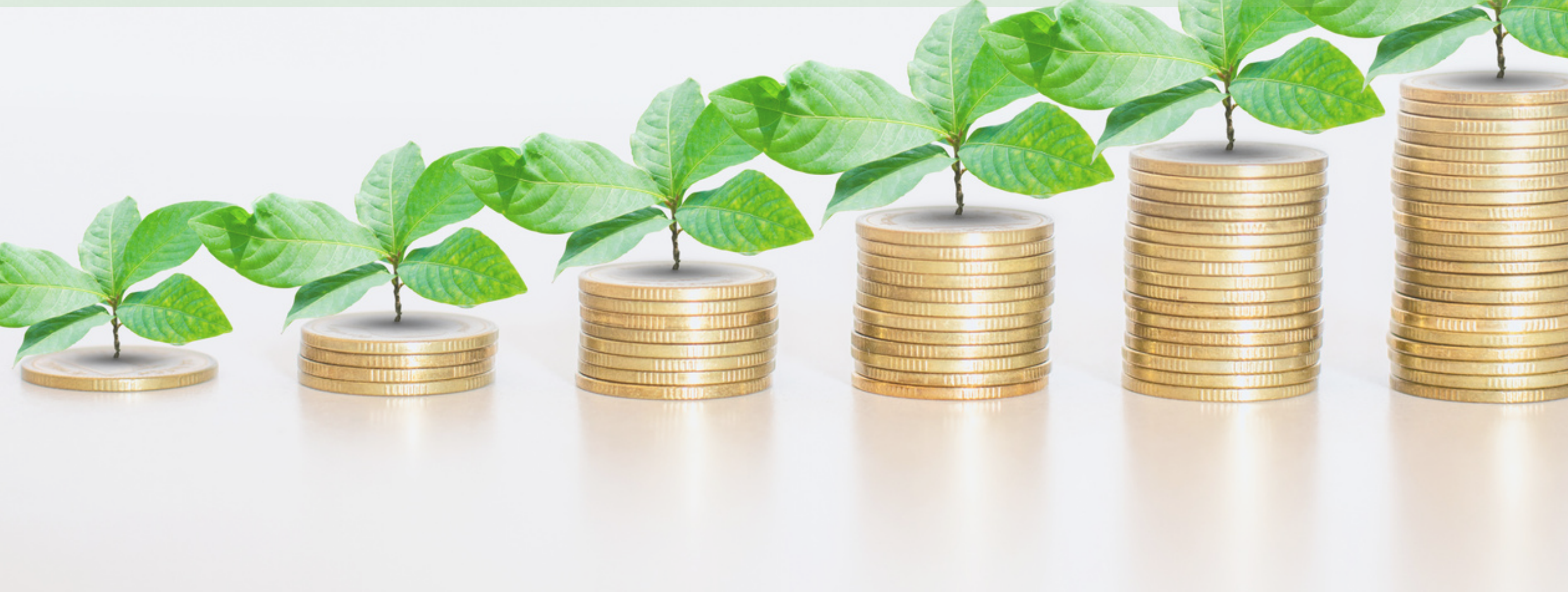
GLOBAL TREASURY INTELLIGENCE

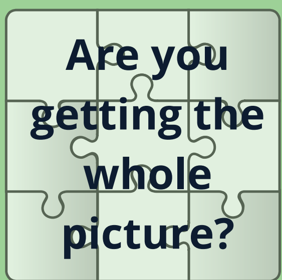
CXC

Corporate Treasury & ESG



Corporate Treasury & ESG: Eight senior treasurers who have started the treasury journey describe their current approach

TREASURY PEER REPORT
JUNE 2021



COMPLEXCOUNTRIES

CONFIDENTIALITY CURIOSITY COLLABORATION

Call date: May 20th, 2021

Expert chair: **Damian Glendinning** (bio at end of report)

Participants: Senior Corporate Treasury professionals from Europe and USA responsible for their company's treasury relating to ESG

Discussion: Participants shared their current approaches ESG from a treasury perspective.

- **Treasury Peer Calls** are expert-moderated discussions between members (senior corporate treasury professionals) of the CompleXCountries treasury peer network.
- **Treasury Peer Calls** are conducted under the 'Chatham House Rule' Details of participants are not disclosed, not all the discussion is reported and some elements redacted.
- **Treasury Peer Calls** are exclusively for corporate treasury professionals and there is no participation from banks, consultants or fintech providers.

HOW TO READ THIS REPORT. The report has been expert compiled and edited to replicate the information exchange and flow of the discussion whilst maintaining the confidentiality of participants. Sensitive information is sometimes excluded or redacted. Each participant is represented by a number but questions and comments are not always attributed. This report was produced by **Monie Lindsey** (bio at end of report).

Chair's Commentary

This was a very lively and full discussion, conducted at the request of a member. The report below details the input, and is well worth reading – but the summary below lays out the key points.

For me, the interesting point which came from all the contributors across a broad spectrum of industries is that ESG now seems to be taken very seriously at the board level, with companies prepared to accept reduced financial returns to meet ESG objectives. Some participants are even reviewing business models and calling into question the traditional focus on growth. Many expressed frustration at the lack of generally accepted standards to set targets and measure progress, though, over time, progress is being made.

Is the world changing?

Key Take-aways:

- The discussion predominantly focused on environmental strategies
- There is universal executive management buy-in and support for the ESG initiatives across all the peers driven by
  - Customer, supplier, and investor demand
  - Concern for the reputational risk and potential negative revenue impact if do nothing
  - Understanding the revenue opportunities of many reduced environmental impact solutions

continued...

Key Take-aways continued...

- Specific treasury initiatives are limited to green investing and demand for counterparty adherence in service and credit negotiations. While decisions that matter typically take place elsewhere in the company, treasury is pulled in
  - When a broader company initiative requires financing or other treasury support
  - When treasury must address outside stakeholder question (e.g., pension fund managers, financial services providers, etc.)
- There is a fundamental logical inconsistency between permanent growth of the business and trying to preserve the environment. However, companies appear to be bridging that gap as evidenced by a shift in cultural perspective – no one on the call questioned support of the ESG initiatives
- There are currently no well-established standards or measurement processes to assess how well an organisation meets the standards and its stated commitments
  - Work has been done and continues on carbon accounting
  - There is no consistency in measurement
  - There was mention of the accounting standards boards as potential arbiters of setting standards and measurements
- A number of creative and impactful initiatives were discussed including
  - Recycling of components for manufacturers
  - Migration to more environmentally friendly packaging
  - Working with suppliers to manufacture closer to markets to reduce energy consumption in transport and packaging
  - Development of products as a service with billing based on product usage, replacing wide scale manufacturing, sale, and shipment of products
  - Using greener energy sources wherever possible.
- Many initiatives have gained success in a company's home market / home region, with less ability to implement in more geographically distant and less environmentally focused countries

ONE

- Historically, we had not investigated ESG at scale. Our initial questions were how to start and where to look for our ESG strategy
- That changed substantially in the course of 2020 inspired by several factors including events placing the focus on social issues and injustice
  - The S aspect of ESG is very, very much a hot topic at our company with its initiatives on diversity and equity and inclusion
- We were among the first businesses in our sector to publish an ESG and sustainability charter and last year we appointed a chief sustainability officer
- A lot of our ESG initiatives cover facilities, manufacturing, supply chain, but less on the financing side
- We are now looking at how we can support these initiatives from a Treasury perspective
- We have received a lot of ideas from our banks especially on the funding side, such as green bonds, sustainability linked credit facilities and we are looking to move some investments to green deposits
- I'd like to hear what other Treasurers are doing to contribute to the ESG agenda.

Question Chair: Are you under any specific pressure to produce Treasury related actions or measurements? Or is it simply a question of how you can participate in the overall effort?

continued...

ONE continued...

Response: Correct. We have investigated it in detail on the funding side. One of the complexities there is managing the rating. You must obtain and maintain the rating and ensure the right controls are in place, so there is a lot of complexity involved in making sure we are ESG compliant. I'd like to learn how to go about getting an ESG rating. Also, for investments, we are USD functional and finding an investment with a reasonable risk that is getting a good return is also a challenge. But I think that is manageable because we are happy to sacrifice margin, but from an economical point of view it's not always advantageous to look at ESG instruments.

Question Chair: That's an important question because there's a whole load of things going on in this area. I suspect we'll come back to the question of the ratings and definitions behind them, because I believe that's very much a moving target. But the other question for me here is: is your company prepared to accept a lower financial return in exchange for better ESG performance? Because, until such time as everybody's adopted these things as universal, I think early adopters will suffer financial penalty.

Response: For our company we do want to sacrifice a bit of yield, but not excessively. We have a strong commitment to ESG and understand that there is a cost associated. I'm pretty sure we will end up with new instruments in our treasury operations.

Comment Chair: I suspect people later in the call will say no actually, if you don't comply with ESG, you will perform worse. But I think there are many situations where that's not yet true.

Response: Also, on the counterparty side, whenever we do an RFP, we now include ESG questions. We have received guidance from our procurement team on this and understand it is based on senior directives.

Question Chair: What kind of answers do you get from banks on this? (ESG questions in RFP).

Response: The banks are also focussing on this, and they provide a lot of material and information. Making sense of it is a different question, because a lot of the information is intangible and hard to quantify. It's about intentions and longer-term plans. But it provides soft data about how the banks are looking at these issues - which is what we want to get out of it at this stage.

Comment: One of the reasons I asked, we have people in the U.S. who I'm sure will have comments on this. What's happening in the U.S. is that some banks, as part of this movement, are refusing to fund companies in the armaments and oil industries. Several U.S. states are moving to make that illegal. Again, there's certainly movement now.

TWO

- I think we are starting to ask some interesting questions, like are we ready to exchange financial returns to meet ESG targets?
- I believe ESG is here to stay and that
  - The pandemic prompted us to change our view
  - We need to keep a medium to long term view
  - ESG will improve the rating of our companies - there are already auditors and rating agencies specialising in providing ESG recognition

continued...

TWO continued...

- What should the role of treasury be in this initiative?
    - To communicate internally that the attention and commitment to meet ESG targets is here to stay at every level.
    - We can incorporate ESG targets in multiple ways
        - Invest in green bonds
        - Ensure our companies incorporate ESG KPIs in their targets – e.g., energy consumption, travel expenses
        - The pandemic helped with travel expenses and we should not ignore the discovery that technology exists that allows us to do many things without the necessity of travel.
        - We should include ESG targets into our credit negotiations and committed lines as well into our investments.
        - Above all, it should be reflected in the objectives of the company every year and in the KPIs that we must achieve if we want to make sure that our company is getting an acceptable rating overall, and we are contributing to the change that has already started.

Question Chair: As flying has considerable environmental impact, do you get asked about this?

Response: Absolutely - more and more investors have asked us about ESG and the fact that we have already implemented ESG targets is viewed very positively. We are committing ourselves to zero carbon by 2022 and investors want specific details on this commitment; they want audited, independent verification of the data.

Question Chair: And how do you find the measurement side? I have the impression that there are quite a lot of different standards out there and different ways of measuring. Do you encounter confusion and concerns here?

Response: There is no standard measurement of ESG related KPIs. This is a critical next step, including for the IFRS to put in place some standard measurements that are applicable to all companies whilst recognising that it depends on what a company does. For example, fuel consumption for an airline is not the same as for a company in agriculture. There's a lot to do in this area. I think the UN has already issued some sustainable trends, and they are working the IFRS to put in place some common standards in terms of measurements.

THREE

- Diversity is a Treasury specific issue for us. The finance team is taking ownership of our own agenda versus leaving it to HR.
- We have our own meetings and are ensuring we are driving the right behaviours across finance globally.
- More Treasury specific, green bonds are a big thing
- Headquarters group will be looking into debt financing
- We'll support them in looking at the lower levels in working capital opportunities, especially given what's happened over the last 12 months to our key customers
    - We're working to see how we can support our customers to ensure they have working capital.
    - It's not fully aligned with sustainability or environmental impact, but more with governance.

continued...

THREE continued...

- On the flip side of the working capital / supply chain financing, we are starting to target suppliers who are more sustainable in their production cycle to provide them aggressive discount opportunities
    - If they wish to discount, they can join our supply chain financing solution, which has been rolled out across Europe and will be going global.
- Going beyond what you'd typically see in the remit of Treasury, our [redacted European] manufacturing sites are carbon neutral on the production side, not the distribution unfortunately.
    - We've investigated power purchase agreements using green energy. To allow that to happen, you must sign long term agreements, not something we would normally recommend.
        - The agreements have various optionality requiring hedge accounting, so Treasury must step in, in an area where there isn't a very strong forward green energy market.
        - We're having to provide some mark to market rationale to maintain the hedge accounting.
        - We're also looking to see where we can roll this out into other countries
    - We're looking at other areas of the production cycle to use more environmentally friendly packaging. This will be successful in some markets, not so successful in others.
    - Some of the solutions have benefits beyond the cost impact. The energy solution we have for [redacted Europe) and are about to replicate in other regions, we think in the long term will be more cost effective than taking coal or other non-sustainable energy sources out of the process.
        - Some of these can provide benefits both on the P&L side and on the sustainable side.
    - As we grow our ESG initiative's international scope, we will be looking at how we distribute
        - We're working with some of our packaging providers to locate their production closer to our sites to significantly reduce shipping.
        - At what point do you build local production rather than ship between regions? Do we need production in the country? If this is providing a significant advantage by not having to ship from far away, then this is where Treasury can step in and help with that side of the agenda.

A huge advantage for us is that the ESG initiative has been driven a lot from the CEO.

- Even though we are based in a different region to group headquarters, we're driving some of the agenda, because we see this as a requirement to do business and to fit in the market for our industry.
- Sometimes ESG can be seen as a negative. We're trying to promote other areas (other than treasury) where treasury can help drive more efficient resource usage for production, better packaging, less distribution, greater recycling.

Question Chair: It sounds to me like you see management buy-in as key.
Response: Agree. Several years ago, we had the opportunity to present and deliver the message to our CEO that we must do something about our production, the use of plastics packaging, and too much distribution. After these meetings, the CEO said, right now I get it. I understand we've got to do this. Otherwise, we're not going to hit the numbers, because we're not selling enough. People are not going to buy our products because in today's environment, in this social media society, they understand we are more than just our product, they understand about our production and where it comes from. They may like an imported product, but not the costs of shipping and the environmental damage. We need to be demonstrating what we're doing to support the environment. After that he was fully on board and there was a recognition that there could be a P&L benefit as well as an environmental benefit.

Comment Chair: Okay, and you've mentioned distribution. Because if you look at today's extended supply chains, generally they're not all that good for the environment.

FOUR

- Our organisation is deeply committed to sustainability.
- We have an ESG framework, with a focus on trying to quantify and measure impacts across the board.
- From a Treasury perspective, we already touched on green bonds and some of the financing implications.
- One of the things I've been working on over the last year is our minority bank investment programme, which is, from a treasury perspective, placing deposits with minority owned financial institutions in the United States to give them more lending capability into their local communities
- The programme has been very successful and recognized across the company.
- The challenge is the different teams involved with sustainability and sustainability reporting.
    - How do we determine the right metrics that need to be measured on this programme?
    - How do we determine the impact? It sounds great placing deposits into minority institutions to facilitate their ability to lend. But how do we turn that into metrics? The Treasury challenge is that many of these institutions are not geared for that type of reporting. And we don't really know what the right metrics are.
    - The other aspect to consider is how appropriate it is to ask these particular banks and institutions to provide metrics when we're not asking the same from the global banks that we work with - even though the global banks are already publishing their own metrics and sustainability reports. The magnitude of their size and resources dwarfs many of the community banks in the U.S. It's an evolving discussion, and we're trying to figure out what we can reasonably ask for, and what is beneficial in measuring the impact of this programme as we continue to grow it and evolve it.
- From an overall Treasury perspective, which we've been addressing on this call, there are a lot of quickly evolving requirements at the country level, at the specific subsidiary level, as well as at the global group level. Trying to figure out what you know, where and how do we respond? And what are the right things to be tracking? And then how do we coordinate and manage data across a very large organisation? I think it's just very, very fluid.

Question Chair: The question, in my mind, when you're talking about dealing with minority owned banks, whether there should be a big difference in returns and service. Clearly, there is a size difference versus the mega banks which may affect the technological capabilities – but otherwise, what changes?
Response: First, I would say there isn't a huge give up in yield, in terms of displacing cash deposits, relative to, say, a two-year Treasury note. But there is a bit of give up. And for us, that's not a consideration. The more important driver is hope for the social benefit of being able to bring capital to these institutions to increase lending, which increases opportunities in the communities they serve. We've also been using certain deposit products that provide U.S. FDIC insurance on those deposits. That basically takes out the credit risk aspect of it since most of these institutions are not public and don't have a credit rating.

FIVE

- We're a little different because it's a family business, albeit a large family business with 50+ companies
- We have renewed interest as a family member has taken a keen interest, produced sustainability reports for all the companies and identified opportunities to reduce our carbon footprint
- For some of our biggest companies, the main thing we have been working on is recycling. We're effectively recycling all the major components and basically rebuilding them instead of just scrapping them. We're rebuilding everything that we can possibly rebuild.

continued...

FIVE continued...

- We're also testing the use of solar energy at our biggest facility with the installation of photovoltaics / solar panels and will then expand to other facilities
- As a result of the sustainability reports, the company is aware of what we are doing that is harmful to the environment, taking steps as above and generally working to minimize our impact. I'd say ESG is a long journey, but that we're off to a good start.

Question Chair: Again, we see the importance of management buy-in, but one quick thing – and feel free not to answer if it's too difficult a question - but do you look at what your customers do with the products? Because some of the products you sell can be used for environmentally harmful practices.
Response: That's a great point and we're looking at it now. It's where most of the bad press is focused, especially in certain industries. We're beginning to help them with their ESG initiatives. To be honest, many already have initiatives underway. Some are even ahead of us. We're also selling to customers in third world countries. We know they have a long way to go.

Question Chair: But the guys that are using these will be using the equipment for the stuff that's reprehensible - usually not the bigger companies, right?
Response: Correct. Usually, it's smaller ones that don't really care. It's not important to them yet or not on their radar yet.

Comment Chair: It's an interesting perspective. But I suppose it does raise another point, which is that there's a market opportunity in terms of providing products that help minimise the environmental impact.
Response: We're also consulting to them on how to do things in a better way. Not to say they'll always listen and do it that way. But now, we can give them advice and guidance on things that are better and more environmentally friendly.

SIX

- Being from a nature loving country where the E in the ESG has always been on top of the agenda, it's quite natural for us to adopt all the ESG parameters.
- As an industrial company providing reliable components, it's in our business to be efficient in the use of energy.
- We are now in the process of changing our whole business model. Instead of selling products, sending the invoice, and getting paid in 30 to 60 days we will now move into what we call the circular economy where our customers pay us monthly for product / service usage rather than a product.
    - With usage, comes services, data, conditions monitoring, etc.
    - What we're trying to achieve is to decouple economic growth or profits from CO_2 emissions.
    - Now we have a commitment to be CO_2 neutral in our production by 2030.
    - That is just the first step after which we will look upstream.
- From a treasury perspective:
    - We launched our first green bond several years ago
    - Investing or depositing our money at a lower rate is not a question for us – we have a firm commitment to prioritize ESG in everything we do
    - As Head of Market Operations, I'm responsible for FX, for all our funding when we issue bonds and for our asset management including pension trusts globally. An ESG policy is embedded in all our investment policies except for the U.S., but it will soon be there.

continued...

SIX continued...

- I'm also part of our Global Energy Committee where Treasury was originally involved to be part of the decision to go for fixed price vs a floating price. Now that role has expanded to focus on how we achieve our green target to be CO_2 neutral
- THREE, we are also looking into virtual power purchase agreements, especially in the US. It would be interesting to have a word with you separately on that topic.
- In our home country, we have roughly 1% of our electricity produced by fossil fuel. But for a company like us with a global footprint, we have challenges in countries like China and a big part of Asia when it comes to green energy.

Question Chair: Thanks. Two questions:

1. On the pension side, can you comment on how you handle the issue of ratings and certification, and
2. I'd also be very interested in hearing more about the shift from manufacturing components to making it more of a subscription type business

Response: Taking the second question first. This change in our model depends on our ability to monitor our clients' usage of our components and only bill our clients for that usage. They pay us as long as everything works. It's a small part of our business currently but growing.

Also, we take responsibility, as FOUR discussed, to recycle or as we also call it, refurbish all our products as much as we can, to create a more circular economy rather than a linear one.

Regarding your question on the investment side, we have a bi-annual meeting where all the funds report. We scrutinize every step they take to make sure they are following the ESG guidelines. For a company like ours, it is critical that we are reliable in our mission to be carbon neutral. We can't afford to invest our pension money into dirty money. Also, it must be global in everything we do, in order not to jeopardise our reputation. The reputational risk of doing something wrong is too high.

Comment Chair: Fascinating.

SEVEN

- Energy is a key component for our industry [redacted] as it is very energy intensive for what we develop
- It is something we've taken major steps to address over the last several years with respect to our ESG strategy and report that we started issuing a couple of years ago. We are focused on all three elements, but particularly the environment – the greenhouse gas intensity associated with our production.
- We've set a target of having 100% of our U.S. energy be renewable by 2025.

Question Chair: Just to make sure you cover it, I also think you use some noxious chemicals or, indeed, typically the industry used to. I don't know, but I assume that is a big focus.

Response: For my brand we pretty much touch on every single element of the periodic table, some of which are benign and some of which are very toxic. We've made a commitment within the sustainability report, to eliminate nearly 100% of all those elements by 2030.

Question Chair: Can you talk a little about the social side of things. It's less your end of the industry, but certainly when you go to the assembly side, there have been some scandals in the industry including a major subcontractor who had many employees committing suicide. And that was very negative for everyone. Is that something that you've come across?

continued...

SEVEN continued...

Response: I think the situation you are speaking of was for a third party. We develop, engineer, and produce all of our own products. That is one of the five pillars of our sustainability strategy. It is associated with people and our employees and supporting diverse cultures and thoughts. We're aware of that situation, but it's not applicable to us. We take a thoughtful approach to make sure that doesn't come into play.

Question Chair: The reason I mentioned it is that obviously being in the industry, we tend to take the same view. But the problem becomes when you are dealing with a subcontractor and they're doing these things, then people start looking at you. I also remember being on a roadshow and having one investor ask me if I'd seen the CNN programme about the use of cobalt in batteries, and the appalling circumstances in which it's mined. Because our products use those batteries, what you increasingly find is that there is an expectation that companies, even if you're not directly involved, will go up and down the supply chain, and audit customers and suppliers. Have you come across that?

Response: That is always a risk. Because of those events, we've become a lot more conscious. However, no matter how much focus you place on sourcing and your supply chain, there are many layers and to really get clarity on that sourcing and the compliance with our social guidelines is challenging. Sourcing is another pillar of our sustainability report that we apply to each of our contractors that we utilise. The way we approach it is to incorporate within our agreements, that they must comply with certain social and environmental guidelines. You're right. You know what you know, but there is a large effort to ensure that you know it's as clean as possible.

Comment Chair: When this gets a high degree of publicity, saying that we did our best is generally not a great answer.

EIGHT

- Our carbon footprint is quite significant and is one of the reasons we have been a pioneer in carbon accounting.
- We started more than 10 years ago and have also been in groups involved in finding how to do carbon accounting, how to involve suppliers, how to calculate footprint, how to calculate offsetting measures.
- We've already gone a long way, not only from the environmental perspective, but also from the social and governance perspectives.
- We have multiple programmes in place ranging from green programmes (tree planting, park cleaning) to natural disaster response
- We recently published a new ESG roadmap
- CO_2 is one of the biggest challenges we face. We have been asked by investors for several years what we are doing about it.
    - One of the things that our board has now decided is that ESG will now be part of their variable pay. We will set up KPIs and goals for each of the three ESG elements. Environment, social and governance will make up a percentage of their remuneration. This has now been implemented in the board payment scheme, driven by investors' demand for action.
    - From a treasury perspective, we are being approached by banks who fund our subsidiaries with questions concerning environmental impact. We are centralising our response to these questions into corporate treasury or regional treasury centres to achieve consistent wording.

continued...

EIGHT continued...

- We are also involved in trading of CO_2 emission certificates. This is in very close cooperation with our divisions who do the carbon accounting,
    - There are rules set up that have to be followed in order to generate the correct calculations.
    - The treasury team then goes to the market and trades these certificates. We are buying a lot of them which is quite expensive.
    - We are now looking into the trading process to see if there's a better way to do it.

Question Chair: Do you use electric vehicles?
Response: Yes, in our effort to reduce our carbon footprint. We have committed to reducing our absolute footprint by 15% which is quite challenging. We have also calculated that if we don't do anything, we would increase our footprint by 40% if left unchecked. We are achieving this target by:

- Implementing electric cars and the use of sustainable fuels as much as available and possible
- Any new buildings have to be environmentally neutral
- All new project spend requests must include a CO_2 reduction figure in the budget request

Comment Chair: Very interesting given that you're in a very challenging industry, at least from an environmental point of view.

END

Our team

Damian Glendinning is chairman of the CompleXCountries Advisory Board, with extensive experience running corporate treasury in complex markets. After 21 years with IBM, Damian joined Lenovo in 2005 as Group Treasurer, following the acquisition of IBM's personal computer business. He had spent four years as IBM's Asia/Pacific treasurer, in Singapore, and was their Director of Global Treasury Operations in New York. Damian is a fellow of the ACCA, and has a degree in French and Italian from Oxford University. He was president of the Association of Corporate Treasurers (Singapore) from June 2010 to July 2018.

Monie Lindsey is a member of the CompleXCountries Advisory Board, with extensive experience consulting to global corporate treasuries, global and regional transaction banks as well as related industry providers. Over a 25+ year career, she has held senior level positions, most notably with Treasury Strategies as Managing Director and Head of the London office. She has a CertICM from the UK ACT, served as a senior assessor for the UK ACT's advanced treasury certifications and served as a member of the EBA's Supply Chain Working Group. She has a degree in Economics from Randolph Macon Woman's College and an MBA from Wake Forest University..

Rupert Keenlyside is founder of CompleXCountries with over 20 years of experience in corporate treasury research and media . He founded gtnews.com in 1997 , establishing it's unique (at the time) editorial model as well as producing numerous research assignments and content projects for global banking clients. After selling gtnews the Association for Finance Professionals (AFP) in 2007 he worked for The Economist Group as director of product development for EuroFinance where he also acquired and ran the Commercial Payments International business (CPI).

www.CompleXCountries.com

Follow us on LinkedIn

Rupert@CompleXCountries.com

CONFIDENTIALITY CURIOSITY COLLABORATION