



Your Treasury Policy Guide

**Pointers to help enhance
your risk framework**

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Foreword

In recent years, the amount of cash held on corporate balance sheets has reached unprecedented levels.

Thanks to this, many of our clients are thinking about or rethinking their cash investment strategies: investigating a wider range of assets, altering or introducing policy guidelines or benchmarks. Cash investment is about identifying appropriate investment objectives for different tranches of cash throughout the economic cycle and there have never been greater opportunities for investment.

To assist you in this increasingly important yet fluctuating task, it gives us pleasure to introduce:

Your treasury policy guide

This guide will give you an idea of how to construct a Treasury Policy framework, describes some of the content and context of developing an investment policy and the factors that may impact your investment decision-making. It is intended to provide pointers if you have never sought formal approval for an investment policy, or to help you validate elements of the policies of those who have. It is not intended to recommend, prescribe or define your policy – that's up to you! Nothing in this document takes into account your company's individual circumstances.

A Treasury Policy's purpose is generally to enable efficient management of financial risk within your company. It formally sets out current treasury activities and establish a treasury risk management environment in which all objectives, policies, and operating parameters are clearly defined.

A Treasury Policy often considers inevitable financial risks and covers all the different activities you undertake. The policy assists with the operation of your treasury and would be supported by your senior management team (or risk management committee) so that financial decisions are made in a controlled manner.

There are many financial risks you may want to manage including FX risk, interest rate risk, liquidity, credit and commodity risk to name a few. You will need to consider creating your own formal, auditable policy that defines a framework for the management of your treasury and this guide intends to help you shape your own policy document.

HSBC Innovation Banking UK offers a range of Cash Management, FX, and Treasury solutions that can help mitigate the risk exposure you have.

David Williams

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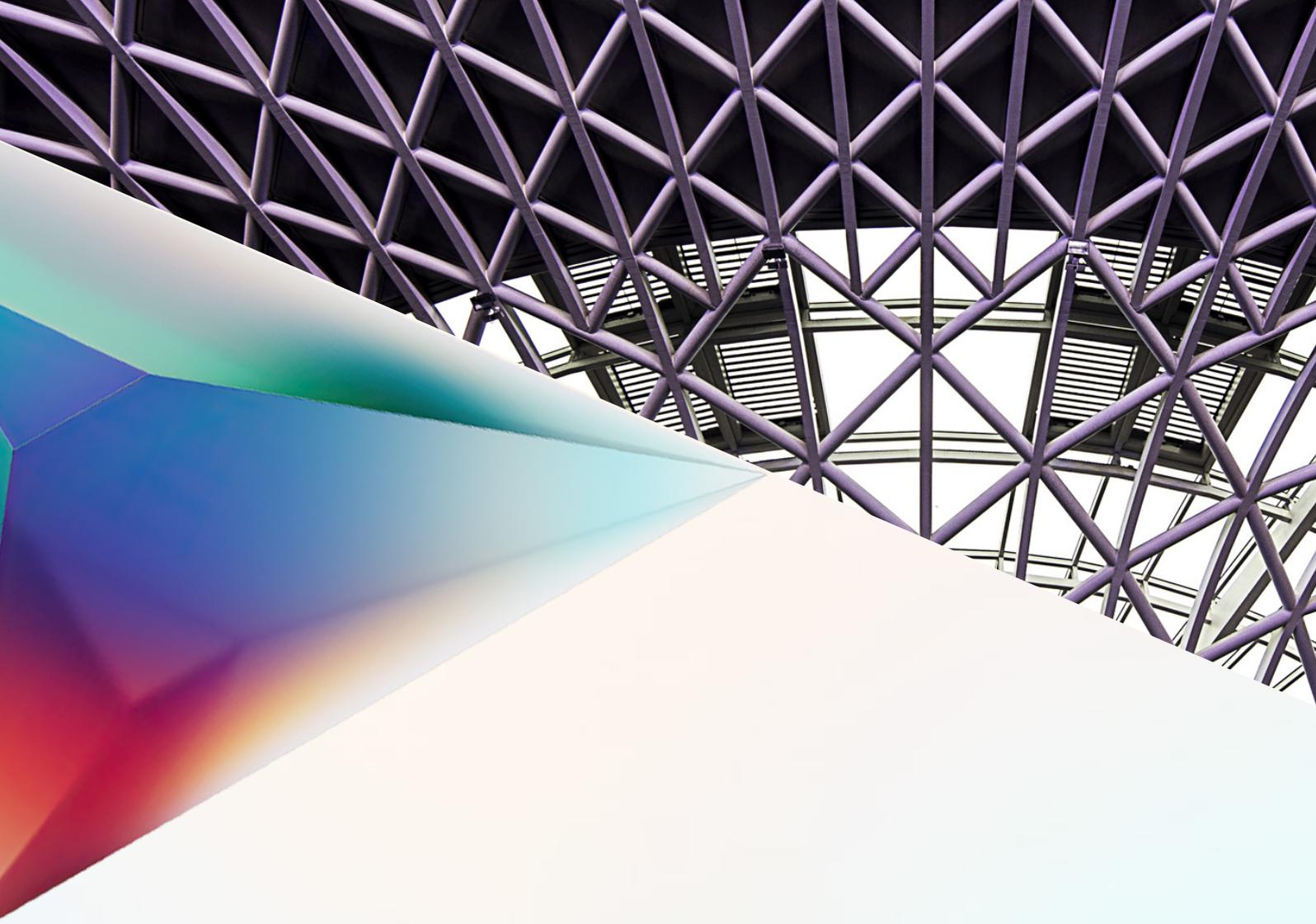
Your Treasury Policy checklist

This example checklist provides you with a starting point for you to adapt¹ and create your own Treasury Policy – it’s not exhaustive and you may want to add to it or remove sections depending on your needs. It does not take into account any of your company’s individual circumstances:

POLICY NAME (IDENTIFY & ASSESS)	What is your document going to be named e.g. [Company Name] Treasury Policy, Liquidity policy etc?
POLICY OBJECTIVE (IDENTIFY & ASSESS)	What is your Treasury Policy trying to achieve? (see: Your objectives – security, liquidity and yield)
RISK DESCRIPTION (IDENTIFY & ASSESS)	What are your risks and how do they arise? (see: Define your risks)
RISK EXPOSURE (EVALUATE)	What is your exposure before and after existing risk mitigation (expressed as the likelihood and size of potential loss or gain)? The measure could vary by type of risk – e.g. counterparty credit exposures based on credit ratings. Additionally, are there any natural hedges (offsetting risks) in your company that reduce the exposure?
RISK APPETITE (EVALUATE)	What is the amount of this risk that your company is willing to take to meet your objectives? The risk exposure typically should not exceed pre-agreed risk appetite.
RISK RESPONSE AVOID, TRANSFER, REDUCE, ACCEPT (RESPOND & CONTROL)	What is your risk response, it typically aligns with the policy objective, for example, eliminate FX transaction risk due to foreign currency receivables. Some options for the risk response: <ul style="list-style-type: none"> i) Avoid (e.g. don’t enter a market) ii) Transfer (e.g. by insurance or to 3rd party) iii) Reduce (e.g. using controls); and iv) Accept (e.g. if not material) (see: Set a strategy to manage your risks)

1. A checklist is published by the Association of Corporate Treasurers

RISK OWNER (EVALUATE)	<p>Which individual/department is responsible for managing the risk? Include when the treasurer should report back to anyone e.g. the board/FD in the company, and list authority limits (if not specified elsewhere).</p> <p>(see: Who does what?)</p>
RISK TRIGGERS (EVALUATE)	<p>What are the risk triggers, have they been determined and approved and is an action plan in place? These triggers are usually warning signs that the exposure is approaching its risk appetite and action may be needed. You may want to create reports to escalate to senior management with recommendations on how to manage the risk exposure, such as reducing the underlying risk or mitigating the exposure.</p> <p>(see: Treasury controls)</p>
KEY RISK CONTROLS (RESPOND & CONTROL)	<p>What are your key risk controls, a mixture of risk controls would be described here: preventative, detective, and corrective. List authorised instruments and, if necessary, hedging strategies. List authorised counterparties with risk limits.</p> <p>(see: Treasury controls)</p>
KEY RISK INDICATORS (REPORT, MONITOR)	<p>Have you selected KRIs that measure the risk exposure, related hedges (if relevant), risk triggers and risk appetite?</p> <p>(see: Treasury controls)</p>
REPORTING (REPORT, MONITOR)	<p>Have you established a system for reporting KRIs and the performance of the associated controls so that senior management can monitor and control the key risks within the company?</p> <p>(see: The importance of reporting)</p>
ASSURANCE (REPORT, MONITOR)	<p>Have you developed a system for ensuring that treasury policies are implemented as agreed? For example, independent regular review of the policy, and design and operating effectiveness of controls.</p> <p>(see: Implementing and reviewing procedure)</p>
UPDATE OF POLICY (MONITOR)	<p>Have you defined the process for updating this policy, including the frequency of update and approval process?</p>



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Your Treasury Policy framework

Policies can vary substantially between companies for a number of reasons, including based on the nature of the business model risk, the degree of flexibility required in meeting risk management objectives and the desired level of specificity. Basic policy considerations are included in this guide at a high level, but this is not an exhaustive list of considerations and does not take into account your company's individual circumstances.

Your policy provides a clearly defined framework for the treasury operations team to follow and are usually divided into the following four key components.

1. **Identify & assess** – what you call your policy, the objectives you set and how you describe your risks.
2. **Evaluate** – review the exposure, appetite and triggers and assign ownership, these are key considerations ahead of any risks being triggered.
3. **Respond & control** – defining the response that will be taken if a risk materialises and putting in place controls to prevent them happening in the first place.
4. **Report & monitor** – measuring, testing, and reporting wraps it all up.
5. **Anything else** you wish to add!

1.

Identify & assess

- ◆ Policy name
- ◆ Policy objective
- ◆ Risk description

2.

Evaluate

- ◆ Risk exposure
- ◆ Risk appetite
- ◆ Risk owner
- ◆ Risk triggers

3.

Respond & control

- ◆ Risk response (the policy)
- ◆ Key risk controls

4.

Report & monitor

- ◆ Key Risk Indicators
- ◆ KRI reporting
- ◆ Control performance
- ◆ Policy assurance
- ◆ Policy updates



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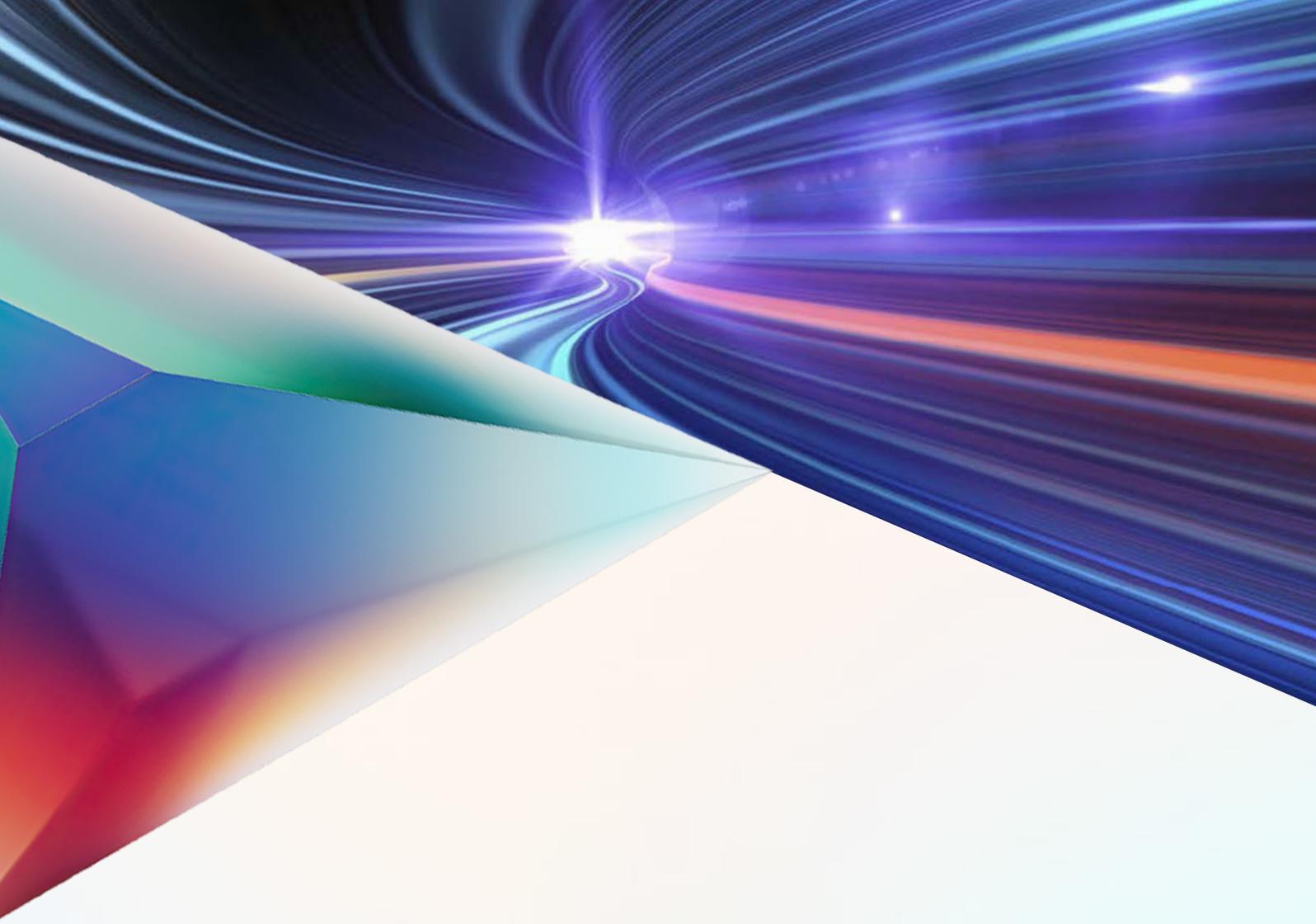
Your objectives – security, liquidity and yield

The objectives should be clear, concise, and relevant. You may want to use existing risk management frameworks and systems within your company where possible and consider how **security, liquidity and yield** relate to one another.

Consider the following:

- ◆ Compliance with relevant risk appetite.
- ◆ Identification of new financial risks arising from operational activities.
- ◆ Compliance with any regulatory requirements and any banking covenants.
- ◆ Availability of diverse funding and capital sources to support medium and long-term growth.
- ◆ Sufficient liquidity and capital are set aside to protect against short-term stresses.
- ◆ Excess funds are optimised for returns.





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Define your risks

Your Treasury Policy should have clear, unambiguous definitions that everyone is familiar with. Documenting these risk definitions is critical and will ensure consistency. These definitions usually state the size and sources of exposure and the types of products that can be used to mitigate them. A policy often evaluates and models the likelihood and size of potential losses or gains.

Risk measures will be determined by the type of risk – for example, FX exposures could have risk measures based on value-at-risk (VaR) and credit exposures risks based on the credit ratings, counterparty risk of the banks, or the providers you use.

You may want to use the risk management policy as an internal communication tool to ensure a consistent understanding across the business.





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Set a strategy to
manage your risks

A policy usually clearly defines the limits for each risk. This will take into consideration the business objectives and how risk adverse your organisation is.

There are a number of options for risk response that you could consider, below are some examples:

Avoid the risk

(Don't enter the specific area?)

Transfer the risk

(Buy insurance or transfer risk to your customer or supplier?)

Reduce the risk

(Use controls?)

Accept the risk

(Is it within your risk appetite?)

Be aware that new risks may arise from your risk response, for example the use of insurance introduces counterparty risk.

Next, policies typically determine and approve triggers for each risk. These are usually treated as warning signs that the exposure is approaching your risk appetite and consider action to mitigate.

You may then consider designing plans in case the actual exposure becomes greater than the trigger and define the reporting that will be used to escalate these breaches. Escalation reporting often includes recommendations on risk mitigation.



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Who does what?

Your Treasury Policy will specify which role or department is responsible for managing the risk, and we see many clients shifting to a centralised risk management approach. To ensure a holistic picture of the risk and consistency identify the following key individuals:

- ◆ Who the treasurer reports to – for example the board or CFO.
- ◆ Who attends your risk committees and who has authority limits and for what.
- ◆ Which management team approvals are needed to accept the exposures.

Typically, we see these departments and teams manage the following areas:

Board

- ◆ Approves all external funding arrangements (which will need to be defined).
- ◆ Delegates responsibility for approval of treasury procedures, controls and detailed policies to the Finance and Investment Committee (or defined/appointed committee).

Finance and investment committee (or defined/appointed committee)

- ◆ Approves the investment and borrowing policy (where applicable).
- ◆ Approves the relevant benchmarks for measuring performance.
- ◆ Reviews and monitors investment and borrowing policy and performance against agreed benchmarks.
- ◆ Ensures there are proper and robust safeguards in place for the security of the company's money by:
 - Agreeing on the list of permitted institutions, investment limits, and permitted investment types for the cash surpluses.
 - Ensuring approved bank mandates are in place for all company accounts and that these are updated regularly for any changes in signatories and authority levels.
- ◆ Monitors compliance with treasury policy and procedures.
- ◆ Delegates responsibility for day-to-day treasury operations to the CFO.



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Treasury controls

Your Treasury Policy should define the controls in place that are used to manage day-to-day risk. You may want to include a mixture of at least **preventative, detective, and corrective** controls.



The objective of the procedures in your Treasury Policy is that your treasury activities are undertaken in a controlled manner to minimise undue operational risk. In particular some controls you may consider are:

- ◆ There is a segregation of duties between staff who initiate payments and account for transactions.
- ◆ All confirmation of transactions from counterparties are checked and recorded.
- ◆ All transactions are recorded in a cash management/treasury system.
- ◆ All payment instructions/confirmations require authorised signatories in accordance with your company's internal policies.
- ◆ Mandates are regularly reviewed and sent to all counterparties.

Maintain a list of authorised instruments and key strategies and assign authorised counterparties with risk limits that can be controlled.

Key Risk Indicators (KRI) are often defined in the Treasury Policy to measure the risk exposure, risk triggers, and risk appetite. Establish a system for reporting KRI and the performance of the associated controls that senior management can monitor and use to control the key risks in your company.



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The importance of reporting

Regular reporting of treasury management is usually considered crucial to the Treasury Policy's effectiveness. These reports help stakeholders see the latest cash position, including transactions and thus help them to review the latest data against your treasury objectives.

Many of our clients produce the following reports, although there are many more that may be applicable to you:

Daily movement report

- ◆ Opening and closing net cash position.
- ◆ The facility available and any amount drawn down.
- ◆ A summary of all borrowings and lending.
- ◆ A review of any banking covenant position.
- ◆ Circulated to the Director and Deputy Director of Finance for their review.

Monthly treasury report

- ◆ An analysis of cash and borrowing.
- ◆ Covenant compliance (as applicable).
- ◆ Liquidity and security of any funding (as applicable).
- ◆ Commentary on bank relationships and services.
- ◆ Debtor days.
- ◆ Creditor days.
- ◆ Gearing and interest rate cover (and exposure).
- ◆ A review of cash and working capital movements.
- ◆ A monthly cash forecast for the next two financial years.
- ◆ Performance monitoring criteria reported on by exception.
- ◆ Reviewed by Deputy Director of Finance.
- ◆ Circulated to Trust Executive Committee and Finance and Investment Committee.



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Performance management and monitoring

To comply with corporate governance, a performance management framework is often used to monitor the effectiveness of your Treasury Policy.

The Board usually delegates authority and responsibility to whomever they see fit (typically the Finance and Investment Committee) to monitor the effectiveness of your Treasury Policy. Reporting back to the Board would often be by exception via e.g. the Finance and Investment Committee.

If the performance monitoring criteria are not operating effectively, the outcome should be rated (e.g. with a RAG status) and an accompanying narrative could be included in the associated finance report circulated to the Finance and Investment Committee for decision.





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Regulatory considerations

Your policy should recognise all the key regulatory requirements that apply to you and allow flexibility to adapt to ongoing changes in the regulatory environment that impacts your business.





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Implementing and reviewing procedure

Ensure your treasury policy is implemented correctly and that an independent regular review of the policy, design, operating effectiveness, and control can be audited.

The process for updating the policy should be set out including the frequency of the update and the approval process.





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Bank relationships and cash management

The development and maintenance of one or more strong banking relationships is an important and key factor to manage your cash. Typically, your Finance Director (or equivalent) will be responsible for managing all banking relationships and ensuring a **consistent approach across banking services** to achieve the optimum benefits for your company.

Key objectives in this area commonly include:

- ◆ Ensuring a competitive price for your banking services.
- ◆ Minimising the cost of borrowing and return on surplus cash within acceptable risk parameters.
- ◆ Developing and maintaining strong relationships with your banks.
- ◆ Monitoring and ensuring compliance with all your banking covenants.

Whatever your stage of business, most banks offer a comprehensive set of banking products and solutions, including cash management, foreign exchange risk solutions and financing solutions that are designed to help support your business scale and grow for success.

Cash management solutions offered in the market can be tailored to work for you and your Treasury Policy.

They can support you with a range of payment services and deposit solutions that scale with your policy needs.



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Your Treasury Policy – a starter for ten

The following non-exhaustive table provides examples of good practice and how you could measure performance. Consider it when examining the needs of Your Treasury Policy.

This does not take into account your company's individual circumstances.

	GOOD PRACTICE	PROCESS	RED FLAGS
1	Bank reconciliations carried out weekly and reviewed monthly	Weekly reconciliations carried out by Cashier Monthly reconciliations completed and passed to Financial Accounts at end of each month	Weekly / monthly reconciliations not undertaken
2	Produce and circulate daily balance movement report for review	Report circulated and reviewed daily	The number of days not distributed / reviewed exceeds the policy
3	All transactions are recorded in the company's cash management system	All invoices entered on ledger within 24 hours of receipt	Invoices not processed within 24 hours of receipt
4	Cash requirement confirmed and authorised before BACS payment runs	BACS paperwork signed by the relevant officer to confirm check undertaken	Any non-compliance occurrences
5	Payment instructions require signatories in accordance with the appendix in your Treasury Policy	Every payment instruction to be in line with the Treasury Management Policy	Any non-compliance occurrences
6	Purchase cards to be issued to staff authorised in line with your Treasury Policy	All applications to be signed by Finance Director / Deputy Director of Finance	Any purchase cards issued without appropriate approval

	GOOD PRACTICE	PROCESS	RED FLAGS
7	All cardholders required to authorise and return statements and receipts monthly	Treasury Report details number of outstanding statements	The number of cardholders with statement overdue exceeds the policy
8	Cards should be suspended if persistent failure to return statements or missing receipts	Treasury Report details the number of suspensions and line management made aware	Any card suspension
9	Temporary changes to cards authorised in line with Treasury Management Policy	Exception forms to be completed and filled for each change on a card, includes evidence of signatory	Any change made without exception process followed
10	Mandates regularly reviewed	Bank Mandates reviewed annually	Last mandate review >12 months

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