Driving strategic values with Corporate Treasury Centre (CTC) in Hong Kong

Background

Through developments in treasury-related regulations and the market, we observe that corporates continuously have increasing needs and interests in setting up an offshore Corporate Treasury Centre ('CTC'), and regulators also echo and call for such movement. In January 2022, the State-owned Assets Supervision and Administration Commission of the State Council ('SASAC') in China issued a Notice on Guiding Opinions[1] which **called for accelerated development of treasury management systems with corporate treasury functions to enhance cash management**. The directive mandates all state-owned enterprises to deploy a centralised treasury system that provides visibility, control and traceability of all subsidiaries' bank accounts and cash flows by the end of 2023. With comprehensive and real-time liquidity monitoring through treasury management systems, corporates can also amplify the effectiveness of their treasury functions. Further to Mainland China's sweeping initiative, the Hong Kong Monetary Authority ('HKMA') has also released 'Corporate Treasury Centres in Hong Kong - New opportunities and case studies" in November 2022 following its initial publication in 2016. Charting success stories across different industries and corporates, it further confirmed the benefits of **setting up a central treasury hub,** and promoted **Hong Kong's competitive advantages as a corporate treasury centre location**.

The COVID-19 crisis, global economic uncertainty and volatility in recent years further underscore the importance of maintaining an effective corporate treasury function, enabling active financial risk management to facilitate corporate strategy. In response to the regulatory guidance and the macroeconomic environment, leading Chinese and overseas corporates are making significant strides towards treasury transformation, and rapidly establishing their CTCs in Hong Kong as part of their strategic business initiatives.

This note aims to provide executives in multinational corporations with our insights on the latest trends in the treasury management and the development of CTCs in Hong Kong.

[1] Note that the Guiding Opinions 《关于推动中央企业加快司库体系建设进一步加强资金管理的意见》issued on January 8, 2022 is only available in Chinese.

What is treasury management?

Treasury management lies at the heart of a company, supporting business strategies and decision-making, enabling active financial risk management, and driving long-run capital allocation planning. Treasury connects front-to-back-end functions to manage six core areas – cash and liquidity management, funding, budgeting and investment, risk management, finance and accounting, and process and control.

Treasury management framework

Cash and liquidity management	Funding	Budgeting and investment
• **Centralise and manage funds** from various business locations to forecast the overall cash position • **Determine cash pooling and sweeping strategy and framework** across overseas accounts • Provide **visibility and control on funds** to reduce financing costs for maintaining business stability within the group	• **Formulate funding strategy** (e.g. short/long term; equity/debt financing) based on budgeting and forecast • Monitor and arrange internal funding to fully **utilise the surplus** and minimise the funding cost • **Optimise the company's capital structure** with funding strategies	• **Manage the overall investment portfolios** to formulate portfolio investment strategies with a centralised view on the surplus and capital requirement • **Monitor segmental cost allocation** for budget management • Determine **utilisation of the company's tangible and intangible assets** with cost-efficient investment strategy
Risk management	**Finance and accounting**	**Process and control**
• Monitor **interest rate positions' exposures** to apply risk mitigation strategies (e.g. hedging financial instruments) • Assess the **onshore and offshore FX exposures regularly** to avoid excess concentration of any particular currency • Determine **hedging strategies** for foreign exchange and interest rate risk management	• Analyse effectiveness testing to formulate hedging strategies and determine appropriate P&L in the book • Support cash and payment reconciliations to identify and resolve discrepancies promptly • Maintain **proper books and records** for complete and accurate financial reporting as foundation for any potential application of **hedge accounting**	• Control and **manage the daily cash flow activities** covering both collections and payments • Conduct **control checking** (e.g. reconciliation) by business segments to identify abnormal activities • **Identify suspicious transactions** at both entity and group levels as a second line of defense through daily control monitoring

Figure 1. Treasury management framework

Why is the market heading towards treasury centralisation and what are the benefits?

CTC is an **in-house bank** providing treasury services across business units within a multinational corporation, typically located in a favorable tax jurisdiction. The CTC is responsible for centrally managing a range of activities including intragroup borrowing and lending, cash and liquidity management, trade settlement, cross-border payments, capital raising and financial risk management.

Three key CTC capabilities and benefits in practice are highlighted:

1. **Intra-group borrowing and lending**

   A major challenge faced by multinational corporations is managing the group's foreign exchange exposures and managing funding for overseas subsidiaries. The CTC structure allows the corporates to maintain an **internal group central lender** with full visibility and oversight of the group's liquidity, facilitating financing to member companies at more competitive rates. This effectively reduces reliance on external borrowers and hence lowers funding costs by internalising the wholesale banking function.

   Locations such as Hong Kong and Singapore even encourage development of CTCs by offering tax benefits on profits from treasury activities, making treasury centralisation a cost-efficient funding solution.

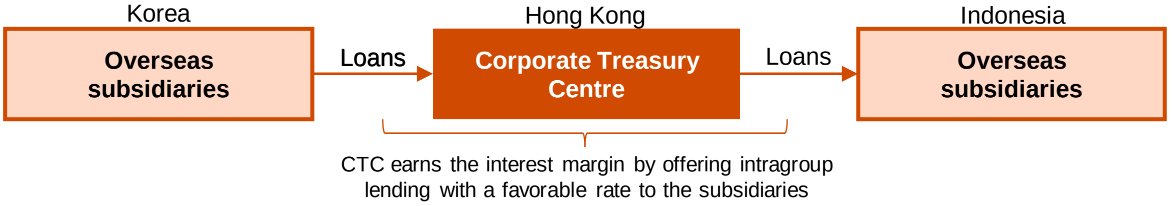


Figure 2. Intra-group borrowing workflow with CTC as a group central bank

2. **Cash pooling and sweeping**

   CTC offers two key techniques to enhance cash management – cash pooling and sweeping, by maintaining **master header accounts**. **Cash pooling** involves combining different bank account balances to one master account for liquidity bundling within the organisation. Corporates select different cash pooling solutions (e.g. physical or notional cash pooling) depending on the corporation's investment strategy and local regulations. **Cash sweeping** is used to optimise returns on excess cash within the company, by sweeping any surplus from subsidiaries' accounts to CTC's header account to pay any outstanding debts. This means that funds can be fully utilised across global operations across time zones and locations to meet payment obligations. While the cross-border fund transfer flexibility may vary across jurisdictions, some sub-header accounts may need to be set up locally to combine all the offshore funds with registration before any cross-border transfers.

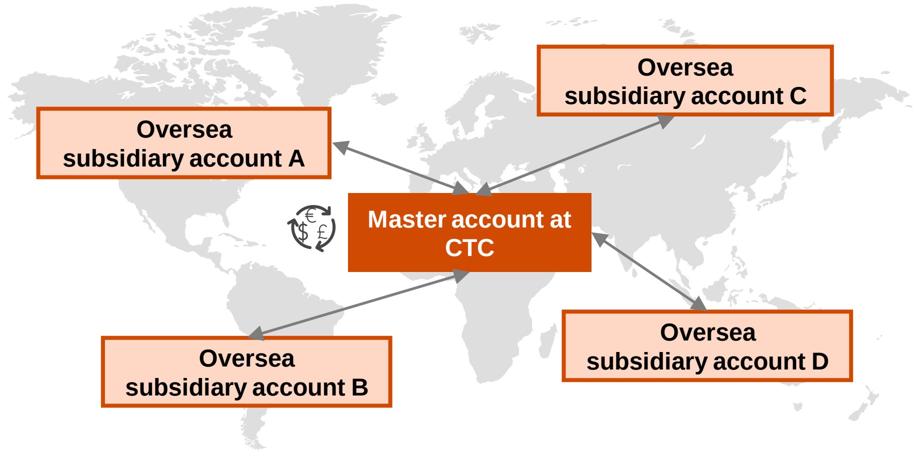
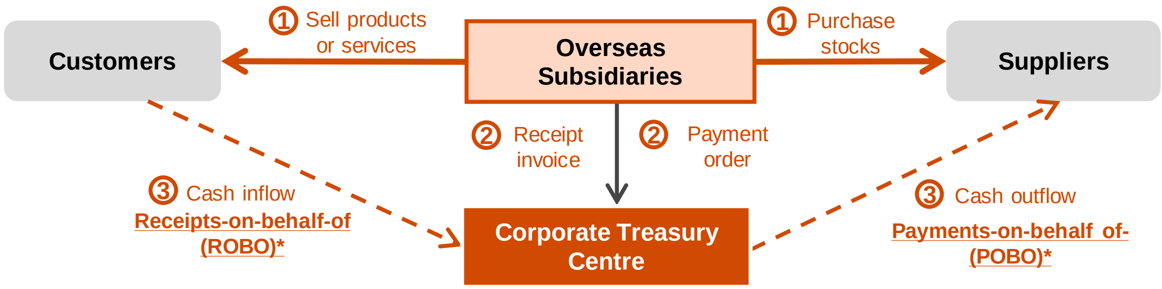


Figure 3. Dynamic between the CTC's master header account and the oversea subsidiaries accounts

3. Global payment hub

From a transaction banking perspective, a CTC also functions as a **global payment hub**, managing payables and receivables on behalf of the corporation's cross-jurisdiction subsidiaries through a central bank account. When overseas subsidiaries execute purchase transactions with their suppliers, the accounts payable update and details are shared with CTC via the treasury management system. The CTC will then execute the payments on behalf of its subsidiaries, i.e. Payments-on-behalf-of ('POBO'). Similarly, when overseas subsidiaries secure their own business deals, the accounts receivable balance and invoice details will be uploaded to CTC, which will then receive the collections on behalf of its subsidiaries, i.e. Receipts-on-behalf-of ('ROBO').



*Some markets have regulatory restrictions on POBO and ROBO for certain treasury activities.

Figure 4. Overview of CTC POBO and ROBO Operation Models

We illustrate below how a multinational corporate operates under a centralised treasury management function, by consolidating all the cash flows into leading header accounts. By transitioning from decentralised functions to a centralised model using CTC, corporates can achieve enhanced cash visibility and capital utilisation. Further CTC benefits can be realised in the significant reduction of operating costs and increased interest income through better cash flow management. However, due to local regulatory restrictions, cross-border cash flow is strictly regulated in some locations and the corporates may need to set up sub-header accounts in their locations before consolidating to the centralised header account.

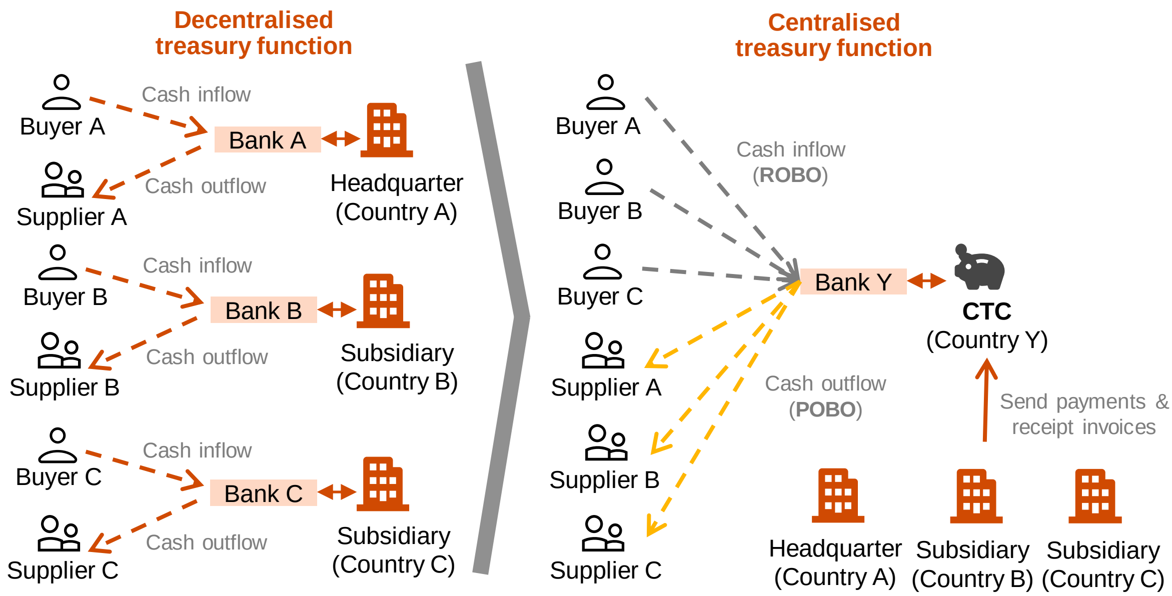


Figure 5. From decentralised to centralised treasury function

Why do corporations set up their CTCs?

Multinational corporations are moving quickly to build and digitise their CTCs, tailoring CTC operating models to their own business and organisation structures to maximise effectiveness.

Major reasons behind this move include:

- **Operating cost savings** - eliminating costs associated with operating distributed treasury functions in different locations such as trade fees, multiple site and account maintenance cost, and staffing expenses.
- **Reduction in external funding cost** – fully utilising working capital through central cash management to reduce reliance on costly external funding or bank overdrafts to achieve interest optimisation.
- **Improved operation efficiency** – centralising and standardising cash and payment operations (e.g. group procurement) to reduce the waste and collaboration challenges across different jurisdictions and time zones with full understanding of business needs.
- **Automated workflow** – adopting advanced technology in their CTCs such as Enterprise Resources Planning (ERP) and Treasury Management System (TMS) to provide an opportunity for simplifying their treasury operations with overview on the balances of account payable and receivable across locations.
- **Robust risk monitoring** – managing liquidity risks and reducing financial risks (e.g. FX and interest rate risks) through intragroup cash pooling and book transfer techniques which allows to take appropriate risk mitigation actions (e.g. hedging).

CTC transition and treasury maturity model

To fully capture the benefits of CTCs, companies must carefully assess their treasury needs and goals to align with their corporate structure, treasury processes, and regional activities. This will enable them to design a CTC structure that meets their specific requirements.

Implementing a CTC model requires companies to adopt different strategies and policies based on their level of maturity in treasury capabilities. Our Corporate Treasury Maturity Model below provides a lightweight framework that differentiates maturity phases in critical areas such as cash and liquidity management, payments, financial risk management, and regulation and compliance. By leveraging this model, companies can effectively assess their current treasury maturity level, identify gaps, and develop a roadmap for achieving their desired level of maturity.

	Beginner	Developing	Mature	Leading
Cash and liquidity	• Inconsistent cash and liquidity management approaches and minimal communication across subsidiaries	• Standardised, defined and documented global cash and liquidity management strategy and operations, yet only followed by some of the subsidiaries	• Technology enabled automation of cash and liquidity management operations across all subsidiaries, with connectivity with ERP, engaged banks, and other financial systems.	• CTC continues to refine the company's treasury operating model and trading strategies for investment and debt management, optimising the use of capital held by subsidiaries
Payments	• Multiple banking relationships for each subsidiary in different jurisdiction • Distributed payment processing for local and cross-border transactions with customers and suppliers	• Centralised payments in some subsidiaries/ markets to manage receivables and payables with customers and suppliers	• CTC header accounts set up to support the entire group with full centralised payment mechanism at CTC to manage POBO and ROBO • Netting applied for payments across all subsidiaries to minimise the banking fees and FX losses	• CTC continues to leverage advanced technology to streamline and automate payments processing, and manage banking relationships at group level
Financial risk management	• No risk management framework is defined nor documented to define the risk appetite including risk limits • Ad-hoc process in place to identify and manage financial risks	• Standardised, defined and documented group risk management framework, including P&P and guidelines, yet not followed by all subsidiaries • Financial risk metrics established to quantify and monitor risk exposures at entity and group level	• Well developed group risk management framework and strategy that is fully integrated into the CTC operations and treasury management system	• CTC continues to optimise the company's risk return profile and align the risk appetite with the overall business strategies
Regulation & Compliance	• Ad-hoc/ regular internal control process to ensure treasury operations across all subsidiaries in different jurisdictions are in compliance with the applicable legal and regulatory requirements (e.g. SOX, data privacy)	• Corporate compliance program established with policies and procedures well documented for managing regulatory risks related to treasury operations, yet not followed by some of the subsidiaries	• Corporate compliance program well developed and integrated in the CTC operations, which enables proactive management for changes in applicable regulatory requirements	• CTC continues to maximise the commercial benefits and reduce costs based on the latest treasury-related legal and regulations (e.g. CTC-related tax regime)

Figure 6. CTC transition and treasury maturity model

Key enablers of setting up an effective CTC

A robust CTC framework should have multiple key success factors. To ensure a smooth implementation and to maximise impact, the newly established CTC should not be treated as a standalone function. Internal and external connectivity through different channels/platforms and data points should be built. Companies are therefore encouraged to have a comprehensive understanding of CTC framework to better formulate their budget and resources plan.

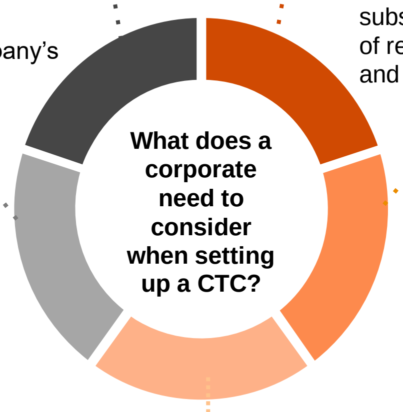
When setting up a CTC, multinational corporations' executives should take the following key enablers into account:

Location

- Choosing the right location for the CTC is critical to align with the corporate treasury strategies with **consideration of organisation's geographic structure** and alignment of company's strategic business growth plan

Banking solution

- Form a sustainable partnership with a trusted bank to open the header accounts to **establish the cash flow network** between CTC and subsidiaries based on the geographic presence of relevant stakeholders (e.g. client segments and suppliers)



Tax and Regulations

- Understand **the legal and regulatory framework** in the selected location of the CTC as well as the operating subsidiaries
- Consider the **local tax laws and cross-border fund restrictions** related to intercompany transactions, non-resident account opening, currency controls, transfer pricing, withholding taxes (WHT) and capitalisation cap etc.

Data and system

- **Implement a Treasury Management System (TMS)** to digitise and automate CTC operations through system connectivity and data integration with existing enterprise resources planning (ERP) systems, banking portals, and other financial systems
- Perform vendor selection to **evaluate the features offered by different TMS vendors** based on the POC defined on the data and business requirements and applicable regulations such as data privacy as well as the scalability to adapt to evolving business needs

Process and control

- **Design the target operating model** to define the process and controls after transforming the key operations such as cash and liquidity planning, and risk management across different business lines and geographical jurisdictions
- **Define and centralise the treasury activities** to align with the corporate strategy based on the business nature and locations to determine the monitoring focus (e.g. FX exposure)

Figure 7. What does a corporate need to consider when setting up a CTC?

Why is Hong Kong a competitive city as your choice of CTC?

Companies, regardless of their sizes and business natures, should note that a desirable CTC location is one of the key factors in formulating a successful treasury strategy. Choosing the right location can maximise CTC's effectiveness and assist companies in expanding their footprints into international markets.

With its geographic and financial competitive advantages, Hong Kong serves as an ideal location for CTC hubs. Its mature financial ecosystem, tax incentives and pool of experienced talents can effectively help corporations to navigate challenges including multiple currencies management, on/off-shore cross-border fund transfer and risk management. Hong Kong's status as the global offshore renminbi business hub will particularly be advantageous and useful to firms with exposures in Chinese markets.

Mature financial ecosystem

Leveraging Hong Kong's extensive banking network and its **mature cross-border bilateral pooling infrastructure** to effectively build a robust global cash management structure and enjoy a **wide range of banking products** for idle cash investments and risk management, especially for on RMB currency-related solutions

Favourable tax environment

Benefiting from the tax regime introduced by the Hong Kong Government, which allows qualifying CTCs to enjoy a concessionary tax rate of 8.25% on profits derived from certain treasury activities (i.e. **half of the prevailing profit tax rate** of 16.5%)

Deep pool of experienced professionals

Offering a deep pool of talents including a trusted banking partner, tax advisors and consultants to explore together the best CTC solution based on the rich experience and **comprehensive knowledges on onshore and offshore legal and regulatory rules**

Figure 8. Why is Hong Kong a competitive city as your choice of CTC?

How can we help?

Understanding that treasury transformations can be complex and challenging, we have developed a powerful suite of tools and solutions to empower multinational corporations in capturing the full value of establishing digital CTCs in Hong Kong.

Our featured services include:

Treasury operating model transformation

- Assess the effectiveness of your current treasury management model against your business strategy, identify changes required, and evaluate the costs and benefits
- Design a future state treasury function by identifying dependencies and collaborating with the relevant stakeholders to implement a treasury operating model with our extensive experiences in change management across people, process and technology

System implementation support

- Support to understand your system infrastructure at both group and entity levels to identify the system and data connectivity requirements for implementing treasury management system
- Gather the business requirements and facilitate discussion during system vendor selection as well as the implementation process in order to achieve a smooth system implementation journey

Tax advisory

- Provide integrated tax solutions for CTC establishment and local qualification, recommend a tax efficient operating structure, advise on tax incentives, and address any tax issues that may arise during the transformation (e.g. transfer pricing)

Risk management advisory

- Assist executives in developing resilient CTCs with risk optimisation strategies that effectively manage liquidity risk, market risk, counterparty credit risk, currency risk and interest rate risk, navigating macroeconomic and geopolitical uncertainties
- Leverage our extensive risk management experiences to provide professional advices on risk appetite establishment including limit set-up and the respective monitoring approaches

Figure 9. What can PwC help?

Contact us

We would be delighted to discuss the contents of the corporate treasury transformation outlined above and explore how it could bring value to your business.

Please reach out to us if you have any questions or queries.

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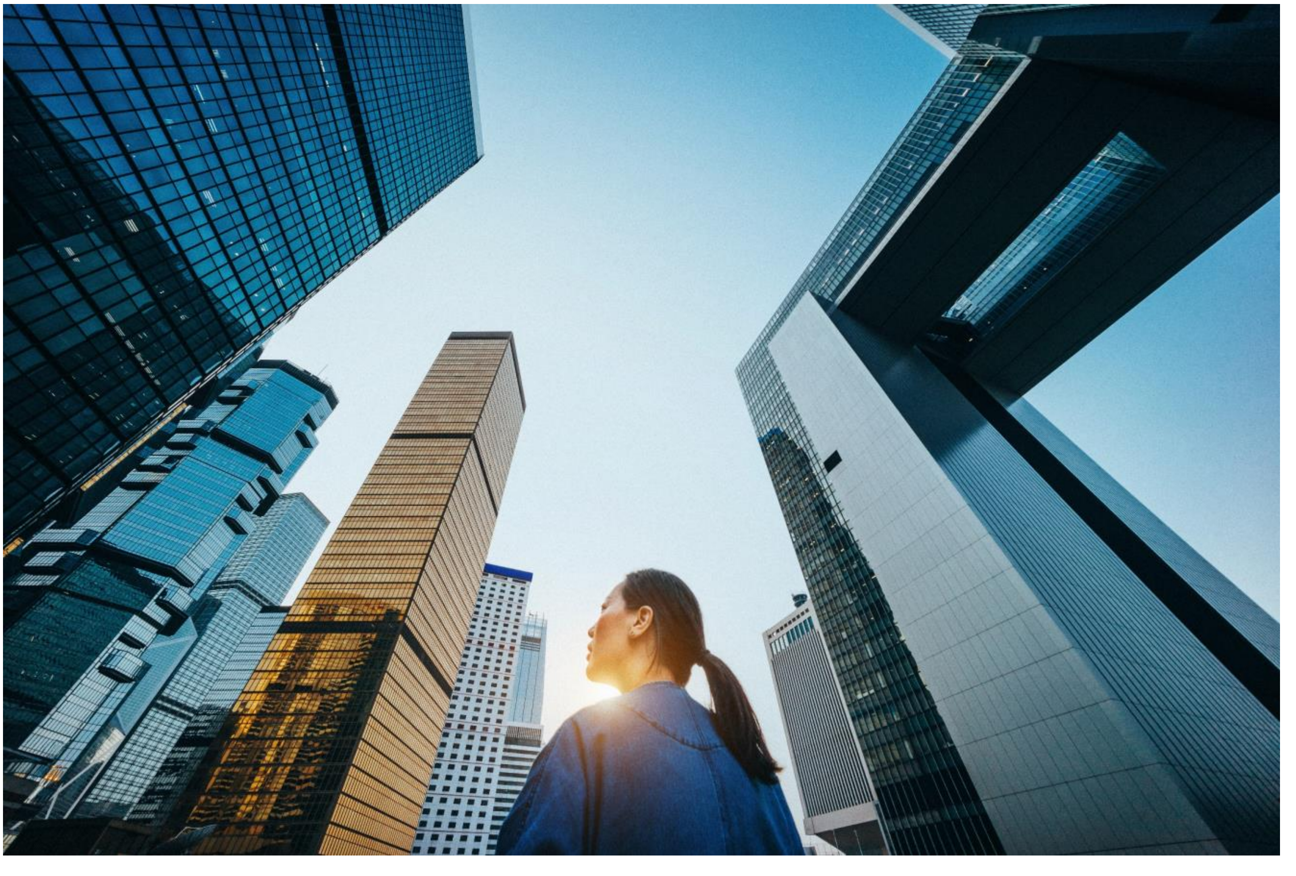

The materials contained in this document were assembled in June 2023 and were based on the law enforceable and information available at that time.