Rewriting the rule book

IN THE WAKE OF THE FINANCIAL CRISIS CORPORATES ARE HAVING TO RETHINK THEIR APPROACH TO RISK. A GOOD STARTING POINT IS TO SPREAD IT MORE THINLY, SAYS **JOSE FRANCO**.

The global financial crisis brought treasury centre stage, with greater importance placed on core functions, controls and processes. As the recession deepened, it became increasingly apparent that a company's ability to answer basic questions around the visibility, access to internal funding and management of counterparty risk depended on the very systems at the heart of a firm.

However, what the crisis highlighted was that the corporate processes and systems in place were, in many instances, woefully inadequate to deal with the fall-out. Stress-testing must take some of the blame for this. Without the very worst-case scenario planning, stress tests were simply not sufficiently stringent to cope with the situations companies faced during the peak of the crisis. The reality of 2008 quite simply presented corporates with a scenario that was far more devastating than their stress tests had covered.

The rise of globalisation has also seen many corporates go through aggressive acquisition strategies, adding firms to fuel growth. The crisis highlighted the problem that companies' policies and processes had not kept pace with their expansion, and many entities were still operating in silos.

REDEFINING RISK Since the crisis, we have seen a radical overhaul of policies, processes and strategy to ensure they are more rigorous and stringent, and match-fit for the darkest conditions and sternest of tests. This is applicable for risk management across the board – counterparty, foreign exchange (FX), sovereign, interest rate, or around the availability of credit.

Corporates now understand all too clearly the need to maintain their cash positions at a level that will enable them to cover operations for the next 30, 60 or 90 days in an absolute worst-case scenario. In contrast to previous cultures, this requires a highly conservative approach to funding levels to ensure the business can operate over an extended period while the market normalises.

Today, companies are looking at their policies and procedures to gauge how consistent they are across the enterprise as a whole, so they can be sure to operate with adequate visibility and control of their cash to be able to make it work for them. To this end, treasurers increasingly seek integrated worldwide solutions to their cash and liquidity management challenges, reflecting their enterprise-wide approach to post-crisis risk.

It is a consequence of the crisis that corporates are now adopting a more cautious and conservative view of their banking providers. This means that the disparate processes which proved so flawed during the financial crisis are being replaced by the centralisation of cashflow and the rationalising of banking relationships. Historically, the decision rested on using one bank for each region or potentially the adoption of one bank globally.

SPREADING THE RISK Today, corporates increasingly choose to spread risk, not only globally, but regionally too. This ensures they do not depend on any one single global bank or small group of regional banks. Rather, they work with several banks that can act as best-in-class providers in each country, brought together into one central multibank hub by a global overlay bank.

This global overlay structure, comprising the inner workings of the integrated system, gathers information from each bank and gives the experience of doing business with one institution. This affords the ability to provide the client with the capability and combined geographic reach of a global banking network.

It brings greater visibility to a corporate's liquidity management, it allows companies to monitor their multibank treasury operations more closely, and it affords greater flexibility around analytics so treasurers can see all their positions in one "snapshot".

The global overlay bank is then able to act as the designated concentration bank, brought together by a multibank solution, automated for efficiency and scale in order to bring cash into one single settled solution. Accommodating this change, risk policies must not only ensure the process is robust for cash to be in the right place at the right time, but must also accommodate other risks around counterparties, sovereign and FX.

We have all seen the speed at which different risks can strike. Previously, treasurers had been complacent about a build-up of large local currency balances, but post-crisis, local currency balances are declining, with swifter business of swaps into less volatile currencies. This is not just a reaction to the financial crisis, it is also a timely and appropriate response to any kind of specific market volatility, as we have seen with the euro zone, and more recently in the Middle East, which has underlined the fast pace of change. These examples of uncertainty are again changing the dynamics of risk management policies, as corporates accommodate this risk to ensure they know where their cash is and that its safety is guaranteed.

Over the last few years, clients have realised that they cannot leave this area to chance, that it must be carefully managed to have a reliable picture of their cash. Clients are becoming increasingly knowledgeable about how they structure this critical function and make careful decisions about who they want to work with, who they are prepared to collaborate with and how they want the structure to work for their organisation.

SUPPORTING CREDIT AND LIQUIDITY RISK MANAGEMENT The global banking model, which effectively means being all things to all people, has been shown to be impossible. However, an effective alternative is to leverage a model which encompasses the banks that our clients want to use locally across their geographic footprint. This nexus, which spreads risk and mitigates counterparty risk, can be centralised with overlay services that bring together a standardised model across the globe, ensures a corporate can automatically upstream its cash into a centralised hub and then utilise that cash in any territory. This provides a much a safer option than dealing with banks that do not have a robust counterparty reputation, and which would otherwise pump needless credit risk back into their own operations.

In the post-crisis quest for liquidity, it is paramount that companies minimise risk, as opposed to looking for yields or tying in cash for a significant period. This is providing a greater impetus for corporates to ensure their local currency cash around the world is accessible, easily converted to a base currency and used for internal funding – not only to meet their diverse needs but also to enable cash to be recycled. With the cost of funding via credit so much more expensive than it used to be, cash is back to being king for reducing costs – either from being overdrawn or for the amount of credit required.

Greater visibility via the utilisation of online electronic banking platforms gives treasurers a snapshot of current global liquidity positions, vital in today's world where credit is both expensive and constrained. Preservation of capital and its liquidity is driving businesses today, therefore necessitating cash mobility, whether physical or notional concentration. Providing centralised automation can assist the flow of internal cash and relieve stress from a credit standpoint for clients by providing a global concentration of surplus working capital that can instead be deployed.

FUTURE RISK MANAGEMENT AND LIQUIDITY PRIORITIES Along with increased globalisation, corporate treasurers have to juggle their operations in more currencies and locations than ever. This means that treasurers have to accommodate the risks, challenges and opportunities of doing business on a global basis. For example, the legislation which allowed the renminbi to be available offshore has expanded the opportunity for treasurers to leverage their related visibility and control within the overall process, from the impact on cashflow to the use of SWIFT in clients' payments processes.

And with the expansion of new currencies, liquidity practices are being broadened to accommodate these changes. Changes to regulations are influencing the operating model for clients, just as they are for banks. The new landscape requires a relationship with open dialogue to help corporates move towards better risk policies and increased transparency.

A collaborative approach of working in tandem with clients is most effective from a liquidity management standpoint, providing the most appropriate solution tailored to specific business needs. This may take the form of cash optimisation from every location around the world, through centralised liquidity management, to ensuring its physical delivery to any given location where there is a funding requirement. Naturally, as the client's business evolves, so will its funding needs, but ensuring the services are nimble and flexible to move with those needs and help support the supply chain finance is critical to positively affecting a corporate's business and profits.

CONCLUSION A global view of liquidity not only arms the treasurer with an all-important snapshot, it also helps give the global overlay bank the flexibility to work with each client on a case-by-case basis and provide bespoke solutions in any geography and currency. Working with a global overlay bank with proven expertise and a commitment to delivery beyond just cash management to provide information and liquidity to every required corner of the world enables treasurers to manage their worldwide risk centrally and have a single snapshot of all their global positions.

No-one can dispute that the recent crisis has brought about a rethink in the way risk is managed and taught valuable lessons which continue to be relevant in how we manage regional crises and volatility, such as the continuing uncertainty in the euro zone and the Middle East. This experience is teaching companies that they must have a much stronger ability to survive in the most challenging worst-case scenarios by ensuring their underlying risk policies are robust enough to cope. This approach will dictate that fundamental business decisions can be taken with more complete and transparent information set against sterner risk policies.

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