# Make sense of turmoil

AS THE EURO ZONE'S ONGOING TROUBLES CONTINUE TO CONCERN BUSINESSES, **FRANCYN STUCKEY** AND **AD VAN DER POEL** EXPLAIN HOW THE IDENTIFICATION OF EURO ZONE EXPOSURES CAN TURN TREASURY INTO A TOWER OF STRENGTH AT A TIME OF UNCERTAINTY.

Bankers and treasurers alike are concerned by the current euro zone situation and there is much speculation and uncertainty the world over. One positive to have come out of the turmoil, however, is the increased awareness and importance of business continuity planning, transparency and risk mitigation. Scenario planning around the exit or default of a country from the euro zone may seem daunting due to the number of variables involved, but there are practical steps that treasurers can implement now to ensure that their organisations are better protected to withstand the storm.

Market conditions have placed even greater emphasis on good cash and risk management practices. What is apparent is that visibility is key, with the euro zone crisis highlighting the importance of corporates' direct and indirect exposures. Over recent months we've seen treasurers re-examining both their own and their banks' euro zone sovereign and bank exposure as well as that of buyers and sellers in their supply chain. As a result of this exercise, it is emerging that some treasurers do not know with any certainty the proportion of their own client base that might not be able to pay their bills should there be a euro zone exit or default event.

Given the uncertainty, it can be very easy to "over-plan" the variety of possible scenarios. The best way to avoid over-planning is to focus on those scenarios that you deem most likely, for example:

- a peripheral euro zone country exits the euro or defaults; or
- a core euro zone country exits the euro or defaults.

Rigorously testing against the most likely scenarios will help treasurers determine the possible impact these events could have on their business, allowing them to prepare for any potential negative outcome and protect their organisation better.

**FAQS OF THE MATTER** Many corporates are asking their banks about the consequences of a country leaving the euro, in particular how quickly their banks could support a new currency and whether their accounts would be redenominated. Some banks can implement a new currency on internal systems quickly and well within the timelines required by external clearing systems. But the complexity doesn't lie here; rather, it exists in linking banks' systems with those in the outside world.

For example, any country leaving the euro and implementing a new clearing system would need to define new rules, regulations, formats and interfaces for that system, and go to the International Organisation for Standardisation to request a new currency code. While some preparation can take place before a new currency is required, the full process would need to be set up and shared with

banks so that the new infrastructure could be tested. Even if much of the existing infrastructure was reused, it would still need to be tested and then implemented across every single bank using that new currency.

In a scenario where a new currency was introduced in a former euro zone country, there would likely be a period of dual currency for a period of up to two years in order to enable the legal implications of exit to be worked through, and to facilitate the smooth transition. Furthermore, if just one country left the currency bloc but the euro continued to be used in the remaining participating nations, it would be likely that corporates affected by this would open a new account in that currency rather than redenominate their existing accounts.

WHILE PREVIOUS GLOBAL CURRENCY PRECEDENTS CAN HELP TO PROVIDE SOME INSIGHT INTO POSSIBLE DEFAULTS, THE EURO ITSELF IS UNIQUE AND THIS FEEDS THE UNCERTAINTY.

While previous global currency precedents can help to provide some insight into possible defaults, the euro itself is unique and this feeds the uncertainty. In this context, preparation is key, and that preparation should go deep, wide and high, as follows.

**GO DEEP** Treasurers should be asking questions of both their banking providers and the key buyers and sellers in their supply chain to ensure they have maximum visibility over euro zone exposures. Even in crisis-free times, this exercise represents good cash management practice and helps with risk mitigation.

To be prepared in times of crisis, treasurers need to delve deep into the cash management information they receive, and carry out a detailed analysis of the data. While a treasurer may know account headline information, they may not know in which countries the accounts are domiciled, with which banks they are held, and whether those banks have concerning exposures. Does the treasurer have direct or indirect exposure to specific countries? For example, even if your treasury centre initiates salary payments from a euro account, can staff in this particular country still access their funds if they are held by a troubled domestic bank?

The same questions that treasurers are asking their banks should be asked of buyers and suppliers. As a result of the uncertainty, some treasurers may become more assertive in their collections processes, perhaps moving to a delivery on payment rather than open account process. For those that retain the open account approach a tightening up of payment deadlines and terms is strongly advised.

**GO WIDE** Treasurers will also need to "go wide", work with their vendors and such partners as their legal teams to ensure that all contracts allow for the rerouting or redenomination of payments.

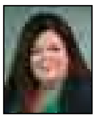
With treasury continuity planning, it is just as vital that treasurers look not only at their euros in one particular euro zone country. If you run shared service centres, then the type of payment makes no difference to an enterprise resource planning or treasury management system – the payment is simply a vendor payment wire, a euro wire or a SEPA (Single Euro Payments Area) payment. The treasurer needs the ability to reroute that payment file and the flexibility to react should a country default. What also needs to be examined is the effort required to introduce a new currency into the system and whether this can be achieved through internal resources alone.

**GO HIGH** To provide transparency, ensure good understanding of potential risks and avoid any potential panic situations, the work that the treasury department does in relation to managing euro zone risk exposure should be shared with senior management and other relevant stakeholders. If a country exits the euro zone and a corporate has an exposure to it, the knowledge that a contingency plan is in place and the company has an acceptable level of tolerance to this can reassure not just senior stakeholders but the market too.

**SIX LIFESAVING STEPS** In the event of a change of circumstances for the euro zone, the following six steps are recommended for corporate treasurers:

- Hold and maintain a complete list of your euro bank accounts. Rationalise these where possible.
- Know your account balances as well as all the payments and receipts due.
- Sweep funds often, and concentrate to your financial centre wherever possible.
- Develop scenarios including business impact and possible mitigations – for example, the redirection of crucial payments through alternative euro accounts.
- Plan for or establish a command centre to enable rapid decision-making as events unfold.
- Ensure your banks have current contact details for your organisation, including outside of business hours information.

**TREASURY IN THE SPOTLIGHT** There is no doubt that the current state of the euro zone has shone a spotlight on corporate treasury best practices and flexibility. It is clear that good cash management and risk management processes are crucial to the smooth running of the treasury function, particularly in times of strife. Cash visibility and cash agility, aided by automation, can help treasurers make sense of the turmoil. Once the core scenario analysis has been done, treasurers are well placed to manage or mitigate their material risk exposures. For corporates that have yet to consider in detail what possible effects the euro zone could have on them, now is a very good time to begin even more rigorous due diligence.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