Ask the experts:

A tough and changing world

GIVEN THE RECESSION AND THE POOR ECONOMIC OUTLOOK WHAT SHOULD THE STRATEGY BE FOR COMPANIES, THE FINANCIAL SECTOR AND TREASURERS IN 2009?

John Grout, policy & technical director, ACT

Chief executive officers and boards are taking more interest in the treasurer's part of the business. Better treasurers will capitalise on the internal "marketing" and career development opportunities.

The world is changing. Revised regulation will help only at the margin but could do damage across a wide swathe. There will be much more tiering of both lenders and borrowers. A really stable state is years away.

Banks have found out more about their own and their competitors' businesses, the value of options (in the broadest sense) and what lies in the non-bank financial sector. They will jealously guard their balance sheets for a while, value them higher for a very long time to come and price up options to rent them as prudence, credit rating requirements and regulatory constraints limit their gearing.

Non-banks (many have already vanished) will be regulated. Brain power will create opportunities just outside the regulations, but credit availability will diminish.

Companies have found out a lot about their banks – and they will remember.

Companies will want to add a lot of language to loan agreements to deal with banks in financial difficulty.

Banks able to provide services across the board and across wide geography will be even fewer. Getting deals underwritten or sold to a bank in a bought deal will not be possible or doable only at high price and on strict terms, often including something about ancillary business, language on credit ratings and an early take-out. "Reasonable efforts" will rule.

For risk management, companies will seek to reduce counterparty risk, using OTC contracts only in special cases and looking to exchange traded products (though FX will be a partial exception).

Given contracting economies, many companies will not be forced to look for extra finance and the longer-funded of them will not need even re-financings for several years (though they will take advantage of opportunities to "fund early and fund long"). Those needing to extend or re-finance will find banks pricing up, perhaps wanting additional compensation on existing credit. Companies which were already at the margin will find themselves un-financeable in their current form.

More companies will need to shape up and go direct to capital markets. Credit ratings will be needed and more bond-investor relations activity will be essential.

Further ahead, we can imagine new exchange-type mechanisms springing up to link issuers and investors directly, disintermediating the banks.

Inside their companies, treasurers will have to be involved in strategic and operational planning and in supervision of all cash-consuming and generating activities, both to improve information flows for financial planning and to ensure that, permanently, sufficient weight is given to cashflows and the balance sheet.

Reminder: Find the ACT's Briefing Note, Contingency Planning for a Downturn, at www.treasurers.org/downturn/actadvice/1008

Jonathan Clarke, independent pension trustee and ex-treasurer

The economic outlook has not been as grim as this for a number of decades, and during this period, treasurers and trustees need to work together to understand and manage the risk and return trade-off with their pension scheme liabilities. The banking landscape has already changed and will continue to change significantly with banks focusing on reducing their leverage, and wanting to reduce borrowing limits, with the dead hand of government involved with key banks.

Companies are likely to be facing significantly higher funding requirements, including from pension schemes, at a time when the raising of credit has never been more difficult. This is exacerbated by the significant divergence of estimating liabilities from the increasingly nonsensical IAS 19 basis, to the actuarial "equity premium", which never seems to deliver!

Larger pension schemes have been rightly focusing on diversification of assets and hedging their interest and inflation liabilities with swaps, however, over the past 12 months, lowly correlated assets have all correlated to one, and the generation of Libor is proving to be a real challenge. Interest and inflation hedging capacity has reduced significantly due to the lack of supply of long-dated debt from utilities etc, and spreads have widened substantially. Banks are rationing their supply, and treasurers should use their corporate buying power to assist their trustees access this limited capacity.

The buy-in market is not proving to be the panacea claimed by some, as pricing is moving higher and capacity is scarce, with an unproven regulatory structure. For underfunded schemes, it is difficult to justify without significant cash contributions from the corporate sponsor.

Trustees rapidly need to develop banking skills, as an understanding of the strength of the corporate sponsor is crucially important. In particular, in a period when companies previously regarded as strong are brought to their knees by excessive leverage, when judged by the banking markets

today. The treasurer is ideally placed to take the lead in representing the company position to trustees, and explain the banking issues.

It is not all doom and gloom, pension schemes have a very valuable asset, which all institutions are crying out for, namely liquidity! Pension schemes typically do not require their assets for liquidity purposes, so should be in a position to demand a significant premium for giving up this liquidity. Until recently, the returns on credit made it a very unattractive area for return-seeking assets, in comparison to the returns in equity, hedge funds etc. However, there are currently assets available with attractive returns and volatility, particularly if held to maturity.

In summary, treasurers and trustees need to work together to ensure that the risk/reward trade-off is fully understood, and assets are made to work hard over the long term. Trustees need to raise their game in terms of governance and ability to identify investment opportunities, and the interaction between covenant strength and investment performance.

The Rt Hon The Lord Mayor of London, Alderman Ian Luder

At this time of financial crisis and impending economic recession, it is all too easy to forget our history. The City has built its world position because it has been able to attract large numbers of very highly skilled people who know that irrespective of gender, race, or creed, they can create successful careers and enjoy a good quality of life here.

The lessons of what has happened must be understood, so that they can help shape sensible remedies and changes and avoid the same thing happening again.

We in the City must remember our priceless reputation for probity and fair dealing and, where forgotten, reclaim it. We need to approach the future with our ancient virtues of honesty, transparency and generosity.

In that light, changes in regulation need to be effective and relevant to the post-2008 world. We should, however, never forget that regulation itself only sets the framework within which business operates. It cannot completely protect society from the impact of bad management decisions.

The right regulation can help us retain London's worldwide competitiveness. Get it wrong and we will for ever regret what we have thrown away in jobs and prosperity across the UK.

Whilst we welcome the plans of the FSA to reform regulation, the industry itself needs to take the lead now in key areas: measuring risk better, deciding which risks to take and, crucially, which not to take, reviewing corporate governance and remuneration systems.

Indeed, my own profession is not immune to this. I am far from certain that the accounting standards on mark-to-market and pension liabilities have served us as well as they might have during this turbulent period, and their impact and detailed application need to be reviewed.

On tax, now more than ever, we have to be careful not to damage London's position with an uncompetitive tax regime. The High Level Group has been a very useful forum for this and other issues.

The volume and breadth of financial services activity conducted here, and the resultant concentration of skilled professionals, make the City the most important non-manufacturing sector of our economy.

Our reputation for free market access, in practice as well as theory, is a continuing comfort to international investors and those seeking investment.

For more than three decades, London has been nurturing, and leads the world in developing, Shariah-compliant finance products. And that work continues. I especially commend the Securities and Investment Institute for creating an Islamic Finance Qualification which has worldwide take up.

Similarly, London leads on the development of carbon trading, which will become ever more vital as we work together to tackle climate change.

The City of London Corporation is committed to working in partnership with the government to ensure that the City retains its world position for the benefit of the UK economy as a whole.

While this has been an extremely difficult period, and while the City has no inherent right to remain the financial powerhouse of the world, we do have the ability to learn from the immediate past, and to build on our strengths. By maintaining and improving the environment in which business can continue to make its contribution to the economy, by ensuring appropriate regulation and taxation, and by maintaining our reputation for integrity and the common law: the financial services sector will remain a key sector in the UK economy; and the City the place in which to do business.

This piece is an extract from Ian Luder's speech at The Lord Mayor's Banquet in November 2008.

Are you…

… looking to attract treasury, risk and corporate finance professionals?

… reach high calibre candidates online and in this dedicated recruitment section?

Contact Nike Baruwa on 020 7847 2582