# EURO CONTINGENCY PLANNING

## Update regarding Greece (June 2015)

This provides an update to the Euro Contingency Planning Briefing Note published in December 2011. Refer to: https://www.treasurers.org/contingencyplanning/euro

This briefing note update may be freely quoted with acknowledgement

**The Association of Corporate Treasurers**

The Association of Corporate Treasurers (ACT) sets the global benchmark for treasury excellence. As the chartered professional body for treasury, we lead the profession through our internationally-recognised suite of treasury qualifications, by defining standards and championing continuous professional development. For further information visit www.treasurers.org

Guidelines about our approach to policy and technical matters are available at www.treasurers.org/technical/manifesto



**Deloitte LLP**

Deloitte LLP is a member of a global network of member firms collectively employing thousands of dedicated professionals globally who provide high value audit, consulting, financial advisory, risk management, and tax services to selected clients. Deloitte's Global Treasury Advisory Service team provides strategic and operational treasury advice and transformation services to companies in all industries and of varying sizes and complexities. http://www2.deloitte.com/uk/en/pages/financial-advisory/solutions/treasury-advisory.html

## Introduction

At the time of writing (16 June 2015) press headlines suggest that a Greek exit from the Euro (or 'Grexit' as it's commonly termed) is a very possible outcome of the burgeoning Greek debt crisis. In recent days Greece's sovereign debt has dropped sharply, sending yields to their highest point so far this year (29% for short term bonds as reported in the financial press on 16 June 2015). The Greek equity market also saw significant falls with an implied volatility at its highest level since January. In the past few days, there have been knock on impacts on the financial markets in other peripheral European countries and the UK Chancellor on Tuesday warned people not to underestimate the potential damage to financial confidence (Financial Times, 16 June 2015). If Greece defaulted and left the Euro, the Hellenic National Bank would acquire the right to create the new national currency – a right it does not currently possess.[1] Whether this happens or not remains to be seen.

Any risk of default by Greece could be mitigated by the issuance of scrip (temporary IOUs) by the Greek government to pay its citizens. This would free up short term cash which could be used to pay back foreign creditors. This system of payment was implemented in California during 2009 as part of its recession recovery plan, with residents effectively providing short term funding to the state. However the risks associated with a Greek scrip are somewhat greater than those faced by California. The Grecian economy has shrunk significantly since 2007 and the value of scrip vouchers is likely to depreciate at an accelerated rate. Additionally, Greek scrip could not be used to purchase foreign goods and services and could lead to a longer term shortage of Euro in the private sector.

A Grexit from the Eurozone presents a number of operational and financial risks to Corporate Treasurers. Changes in foreign exchange parities arising from Greece ceasing to utilise the Euro are likely to lead to increased foreign exchange exposures and strained working capital cycles. For those corporates with businesses in Greece, or who buy and sell goods in Greece, treasury functions will need effective communication with local sales and procurement staff so that mitigation plans are in place on day one.

This Briefing Note Update is intended to give the corporate treasurer a check list of action plans to consider if in fact Greece does exit from the Euro. As noted above this may or may not occur. The checklist is by no means complete as every business and their associated financial risks are different. We also have not considered the knock-on impact on the wider financial markets and hence potential impacts on businesses in the rest of Europe. This update assumes readers will also refer to the original Briefing Note: https://www.treasurers.org/contingencyplanning/euro

## What is at risk?

### 1. Cash and Cash management

What happens to cash[2] held in Greece? The risk is that it may be redenominated to a weaker currency and becomes subject to foreign exchange controls. A treasurer needs to not only consider the value and access of local cash, but also the impact an exit may have on cross–border cash management structures and the disruption of cash flows.

Some of the elements that would be at risk include:

- Devaluation of cash or deposits held in Greece. Any excess cash held in the country may be at risk.
- Cash trapped in Greece may be difficult to extract due to changes in foreign exchange controls.
- Interruption to Greek bank systems could lead to bank accounts no longer functioning. How will you continue to pay your suppliers and local staff?
- Disruption of local cash flows and hence material changes in local liquidity requirements. A changed pattern and timings of cash flow may appear as customers and suppliers in Greece struggle to manage liquidity.

A checklist of key actions – Now and on Day 1:

- Have you got an up-to-date position of cash held in Greece or in branches of Greek banks?
- Have you considered extracting surplus cash from Greece subsidiaries and minimising local cash to the extent operationally feasible?
- Have you assessed the current and forecast liquidity requirements of operations including under a stress scenario of Greece exiting/defaulting?
- Have you assessed the impact of excluding Greece from any cross border Euro pooling structures?
- If your Greek operations typically use external debt funding, do you have plans in place for alternative and/or increased sources?

[1] Coppola Comment Blog, Wednesday 3 June 2015 "Oh dear, Professor Sinn….." http://coppolacomment.blogspot.co.uk/2015/06/oh-dear-professor-sinn.html
[2] Cash refers to physical cash and money in bank accounts etc. Treasurers need to consider money held in Greed banks, and Greek branches/subsidiaries of foreign banks e.g. a UK bank with operations in Greece.

- Are there procedures in place to react to changes in cash flows? (if applicable Shared Service Centre payments/receipts)Could you survive the day/week/month if Greek bank accounts were no longer accessible or functioning?
- Do you have cash deposits in Greece that may be at risk, for example with your suppliers (such as hotels in the tourism sector) in the event that they default?

## 2. Debt and Credit facilities

What happens to debt held in Euro that is used to fund operations in Greece? The risk is that local profits could be earned in a weaker currency but required to service debt that possibly continues to be denominated in Euro, making the debt more expensive to service. In addition, sources of credit in Greece may become difficult to obtain.

Some of the elements that would be at risk include:

- Availability of bank credit in Greece may become difficult to obtain. Additionally, cost of finance raised outside Greece but relating to Greece operations may increase due to additional credit risk.
- For borrowers in Greece, Euro debt located outside the country may stay denominated in Euros whereas assets may convert to a weaker currency. This mismatch is likely to result in FX losses and hit profitability
- Debt facility covenants based on net debt and cash at bank requirements may be in breach due to weakening of local currency.

A checklist of key actions – Now and on Day 1:

- Have you identified the earnings in Greece that currently service Euro debt?
- Where possible, have you considered borrowing locally (as this may increase possibility that the debt would be redenominated in a new weaker currency)?
- Have you reviewed the terms of the respective debt agreements? Do you have a view (appreciating it will be difficult to have certainty) whether debt will stay in Euro or redenominate to a new currency?
- Have you quantified the potential impact of these events on your financial covenants?
- Do you have visibility of the longer term funding requirement for operations in Greece?
- Have you researched local sources of funding in Greece?

## 3. Credit risk

The risk of one or more Greeks bank defaulting is real. This requires timely monitoring of financial credit exposures by counterparty by country. For example, in the recent Cypriot banking crisis the UK branches of the Cypriot banks were supported by the UK central bank. This may or may not happen with the Greek banks.

Some of the elements that would be at risk include:

- Loss of Greek bank deposits, money market investments, and derivative positions
- Loss of debt facilities, letters of credit and guarantees underwritten by Greek banks

A checklist of key actions – Now and on Day 1:
Assuming your Greek counterparty bank defaults

- What is your actual bank cash position by country? (different European central banks may provide differing levels of support for local branches)
- What are the gross ‘in the money’ and ‘out of the money’ valuations on derivative positions?
- Do you have netting arrangements in place with the banks? Is there a risk that banks could call their assets whilst potentially defaulting on their liabilities?
- What exposure do your money market fund investments have to Greece?
- What value of Letters of Credit and Guarantees do you hold with your Greek banks?
- Check whether your credit insurance covers this event

## 4. Foreign exchange and derivatives

Treasurers need to consider FX exposures that arise directly or indirectly from Greece. In the longer term the FX hedging policy may need to be adjusted to reflect the changed currency profile of the business.

Some of the elements that would be at risk include:

- Greek Euro exposures currently deemed hedged may become unhedged
- Euro denominated derivatives held with Greek banks may be redenominated or unenforceable
- The above could lead to potential mismatches and material FX gains/losses with a negative impact both on profit margins and cash and a failure to achieve hedge accounting
- A potential mismatch of debt funding by currency if Euro debt (in non-Greek bank) remains Euro but underlying assets are redenominated
- Business cash flows potentially impacted by relative economics of redenominated cross border Greek sales and purchases

A checklist of key actions – Now and on Day 1:

- What is your actual Euro exposure for Greece, split between underlying exposures and FX hedges
- Review each Greek Euro hedge by transaction to understand impact of hedges potentially not remaining (pre-transactional, transactional and translational hedges)
- Review any debt funding involving Greek assets or Greek banks for potential FX mismatches
- Consider the impact of a new Greek currency on the relative economies of cross-border sales and purchases

## Contact details

Michelle Price, Associate Policy & Technical Director, Association of Corporate Treasurers
+44 (0)20 7847 2578 or mprice@treasurers.org

Karlien Porre, Partner Treasury Advisory, Deloitte
+44 (0)20 7303 5153 or kporre@deloitte.co.uk