privileged access to fee-earning opportunities. It is not clear what obligation treasurers would then have to favour lending banks. One of the results of the mini-survey was that two-thirds of respondents would not pay a margin over market to their relationship banks.

One of the chief difficulties with the traditional relationship banking model is that it is not usually clear where the balance of risk and reward truly lies. Treasurers vary in their monitoring of what business their banks are transacting with them, and banks vary in their ability to assess how much they are earning from clients overall. One observation was that some banks are binary in their decisions: they will either lend or not lend, regardless of the total earnings from the client, which is scarcely a sophisticated approach.

On the other hand, there was an astute comment that while in most parts of a company people pay close attention to supplier management (to make sure that key suppliers are adequately remunerated to stay in business), this does not necessarily apply to the providers of finance and banking services. The problem will not get any easier with regulators changing the cost of capital, which affects not only loans but also FX deals and even BACS limits.

Perhaps deposits will become more prominent as part of the relationship equation, given that the banks make a lot of money from them. However, if concentrated, deposits potentially give rise to counterparty risk for corporates and, from a regulatory point of view (individual liquidity adequacy assessments), deposits of under three months are no use to banks when stress-testing their liquidity.

As a result, a full and frank discussion between bank and corporate on the approach of each side was a strong recommendation of the meeting to improve transparency: perhaps this is the real definition of relationship banking.

This part of the discussion also touched on regulatory proposals to split banks into “safe” and “racy” parts, if anyone can decide what those are. If this split happens, there will be obvious implications for relationship banking in the future.

WHERE DO WE GO FROM HERE? Looking back, the meeting covered a lot of ground in just 75 minutes, and touched on issues relevant to corporates of all sizes. A clear message is that treasurers will need to keep tabs on – and, more proactively, contribute to – proposed regulatory reforms, which are being driven by politicians and civil servants, and fraught with unintended consequences. One might wonder also how far non-bank lending will permanently displace bank lending. Is it sensible in the long run to put the primary burden of funding corporates onto bond investors, who rely mainly on rating agencies (somewhat discredited by recent events) rather than the banks, whose key skill is to make credit judgements?

Will Spinney is technical officer for education at the ACT.
wspinney@treasurers.org
David Wilson is a London regional group organiser.
dwilson@treasurers.org

The rate stuff

MARTIN O’DONOVAN REPORTS FROM A RECENT DUBLIN REGIONAL GROUP MEETING THAT EXPLORED THE INCREASINGLY TIMELY TOPIC OF HOW TO GET A CREDIT RATING.

Treasurers like to share their experiences and expertise with other treasurers, as is clear from the international co-operation between national treasury associations. In that spirit the Irish Association of Corporate Treasurers (IACT) and the ACT Dublin regional group held a joint breakfast meeting in May at which Standard & Poor’s explained the process of getting a credit rating and how best a company can present a case to its bankers.

The beauty of a credit rating is how the agency’s opinion is summed up in the rating category. This headline simplicity has its conveniences but to stop there is to misunderstand the real work done in reaching that assessment. There are, in fact, various forms of issuer rating – corporate, financial strength and counterparty, and various forms of issue rating covering bonds, programmes, bank loans or recovery ratings for higher risk issues. The current levels are one thing but it is the outlook (positive, negative, stable or developing) which is crucial, as would be any creditwatch warning of a possible near-term change.

Timothy Poole, director of client business management, EAME, for S&P, demonstrated from S&P’s published information how the various key financial ratios typically matched up to specific rating levels. For example, for US industrials a debt/EBITDA ratio of 1 puts the company at AA, 2.3 times at BBB, and 3 times at BB. Treasurers may like to deal only with banks rated A- or better, but looking at the global distribution of ratings, less than half of S&P’s ratings are in the investment-grade section of BBB- or better; the most common rating level is just a single B.

But looking at averaged financial ratios does not tell the complete story. In reaching its credit rating opinion S&P weighs up the combination of business risk profile (the nature of the business and the market for the company’s product or service) and financial risk (the structure and dynamics of the P&L, cashflow and balance sheet). A company with a significant financial risk and an excellent business risk profile might come out at A-, but the same financial

risk profile in a merely satisfactory business risk environment could see the rating drop to BB+.

The rating agencies are clearly conscious of the damage to their reputation from the financial failures during the crisis but over time the relative risk taken from cumulative default rates correlates very well with the rating levels. That said, S&P aims to set ratings so they do not change too frequently. It rates through the economic cycle so that the default percentages in any year vary. Pre-crisis speculative-grade defaults were running at a very low level of 1% to 2% whereas at the end of 2009 they were up to 11.75%; in 2010 they are expected to fall back to 8.7% in the base case scenario.

To gain a rating, a company will need to organise a meeting with senior management and provide information on its corporate profile (its organisation, governance and strategy) and operating profile (business segments, outlook, competition, key risks and financials). The volume of information may seem daunting but S&P maintained that everything it wanted to see should be material that the company produces anyway in the course of its normal reporting cycle. The ACT supports that view and advises that getting a rating need not be overly burdensome and is well worth doing. With the access to bank finance likely to be constrained in the future, more and more companies should be thinking about the capital markets and hence about ratings.

Looking forward, the 60 or so treasurers from the IACT and ACT present at the meeting heard about the ways in which S&P is modifying or developing its approach. For speculative-grade ratings and outlooks, it is adjusting its time horizons to emphasise two years and one year respectively. It is placing greater emphasis on short-term considerations, focusing on long-term factors where they are reasonably predictable. Its analysis will focus more on the level of certainty and the impact and shorter-term threats and opportunities to the business risk assessment. And, as is well recognised by everyone now, liquidity is key.

Martin O'Donovan is assistant director, policy and technical, at the ACT.
modonovan@treasurers.org

The ACT has published guides to credit ratings in its International Handbook and on its website at www.treasurers.org/node/5949 and www.treasurers.org/node/3941

Box 1: Treasury management in Ireland

In relative terms, treasury management is a particularly important activity in the Irish economy. This stems from Ireland's position as a major financial hub via the International Financial Services Centre, the presence of many leading global multinational corporations, and the fact that Ireland has one of the most open trading economies in the world. With the US and UK as two of the country's biggest trading partners, foreign exchange risk management takes on added importance. In this environment, treasury associations have much to contribute. The ACT in Ireland is well represented with over 110 members and more than 20 students, and has started to look at increasing its programme of activities.

In addition to the ACT, Irish based treasury professionals are also supported by the Irish Association of Corporate Treasurers (IACT). Given that many treasurers have membership of both the ACT and IACT and the members of both associations have common interests and needs, we have agreed to collaborate with IACT to ensure treasury issues are well understood by the corporate and financial sectors. This co-operation includes sharing technical knowledge, hosting regular members meetings (open to both sets of members) every 4-8 weeks and sharing members' different experiences. In this way we expect treasurers in Ireland to make a growing contribution to Irish corporate life, economy and the ACT. Collaboration will ensure that the strength of both institutions can be leveraged to maximum effect. Hearing first hand from financial service providers is a prime example of this.

It is also gratifying that ACT chief executive Stuart Siddall and members of the ACT policy and technical team met members recently in Dublin. The ACT can play an important supporting role for its members in Ireland which we can build on in the future.

John Moclair works for Bank of Ireland Global Markets and is the ACT's regional group organiser in Ireland.
jmoclair@treasurers.org