The heat is still on

THE 2012 BARCLAYS/ACT GLOBAL CORPORATE RISK MANAGEMENT SURVEY REVEALS THE ISSUES THAT TREASURERS ARE CURRENTLY FACING IN THE CONTEXT OF A CHALLENGING RISK ENVIRONMENT.

At a headline level, the 2012 survey clearly shows that treasurers are focused on a broader range of risks than two years ago. Where transactional and operational issues used to dominate, strategic and macro-economic issues now top the list of concerns. The survey also indicates that, hand in hand with the economic outlook, treasurers are far more aware of counterparty credit risks and are demanding a better quality of relationship from their banking partners.

The 2010 survey highlighted four trends in risk management:

- a multiplication of risks for treasurers to manage;
- greater sophistication in treasury activity;
- an increased emphasis on relationship-led banking; and
- a growing recognition of treasury as a value generator through active risk management.

Rodolphe Alexis, managing director, head of corporate foreign exchange EMEA, Barclays Investment Banking, says: "This survey clearly reflects the hot topics raised by our clients. Since the financial crisis, treasurers are a lot more aware of the range of risks they need to manage, particularly in areas such as emerging markets, counterparty risk and market liquidity."

PACE OF CHANGE

Comparing the 2012 and 2010 surveys highlights a number of key areas where the risk management focus has intensified:

- Reducing earnings volatility has become even more clearly the top risk management objective for corporate treasurers; however, risk management as a value-added activity is still an important factor.
- Foreign exchange (FX) transaction risk is still the highest ranked risk management concern among treasurers.
- Over 40% of corporates are actively hedging emerging market FX risk and one-third cite emerging markets as a driver of change in their risk management approach.
- The level of concern over counterparty risk has become the third highest ranked risk management concern and corporates now put counterparty credit quality as the second most important factor when choosing banks for their risk management execution.
- Banking relationships have been simplified, with treasurers tending to do less segmentation of banking partners by capability and increasingly asking all core banks for risk management support.

These changes at a policy and strategic level are arguably a direct result of the ongoing economic crisis. Anecdotally, corporate treasuries are becoming more sophisticated in how they manage their banking group, often using dynamic, market-based approaches in assessing which banks to transact with. Keith Gilmour, director, head of UK major corporate FX, Barclays Investment Banking, says: "We regularly discuss issues such as liquidity, hedge portfolio composition and banks' own CDS levels with clients, which is a significant change from only two years ago. Clients are increasingly more attuned to their counterparty exposures."

Additionally, the 2012 survey highlights how actual risk management practices have moved on:

- The mix of FX risks hedged is broadly similar, but with a decrease in balance sheet hedging and an increase in contingent risk hedging, such as risks linked to events including acquisitions or disposals.
- FX options are still a key risk management tool and, where used, treasuries are increasing their use of structured products.
- Emerging markets FX risks are now hedged by a wider range of corporates, with over one-third actively managing them and often using a different approach from their exposures in G10 countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, the UK and the US, with Switzerland playing a minor role).
- There has been a slight move to higher levels of fixed debt, but this is in the broader context of a lower rates environment. Vanilla swaps, cross-currency swaps and inflation swaps have all increased in importance.

- Foreign earnings/net investment risk has moved down the rankings as an area of risk management concern.

Finally, there are a number of risk management areas where corporate behaviour seems to have remained much the same since 2010:

- Pricing and execution capabilities still dominate the choice of risk management providers.
- E-commerce usage has not grown between surveys, with just over a third of corporates not using any form of e-commerce for their FX execution.
- Hedge accounting is increasing as a concern, but the majority of respondents rate hedge accounting issues as not being high-impact for their businesses.
- Use of a hedge co-ordinator for interest rate hedging is broadly unchanged, with the benefits being cited as efficient execution and optimal pricing.

The drivers of changing behaviours are fairly clear, with 80% saying that market volatility combined with a change in market fundamentals – such as low interest rates – is the number one driver of changes in risk management behaviour. The second most important driver has been changes in business volumes and debt profiles, with concerns over credit quality being the third most important. Somewhat surprisingly, extreme valuation in currencies, for example on a PPP (purchasing power parity) basis, is not considered an important driver.

IT'S THE ECONOMY, STUPID The 2012 survey takes a broader look at the concerns of treasurers and shows that macro-economic issues clearly dominate. An escalation in the euro area sovereign debt crisis is the number one ranked market-driven concern for 2012. Combining this with continuing volatile markets and the risk of a global double-dip recession, the survey shows that 60% of respondents are focusing on these large, strategic issues. Following on from this, nearly one in five of respondents cites counterparty risk as the most important market-driven concern.

In terms of risk management objectives, 92% of respondents ranked reducing earnings volatility as a top three objective. This outweighs "value-added" considerations such as achieving budget rates or providing competitive advantage. Given the potential impact of volatile markets on a company's revenues and earnings, an increased focus on hedging strategies is a natural consequence of this.

When implementing a risk management strategy, the most important considerations given by treasurers, leaving aside price, are liquidity and credit lines. Risk management activity is being driven by these critical constraints, which has led to a focus on simpler solutions to achieve the risk management objectives. Accounting is also a commonly cited driver of choice of hedging solutions; however, the survey shows that three-quarters of corporates do not require all solutions to achieve hedge accounting. Additionally, almost half do not expect the forthcoming changes brought about by the replacement of IAS 39 by IFRS 9: Financial Instruments to affect their hedging approach, with one-quarter expecting that it may even allow them to increase their use of derivative solutions.

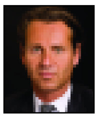
For the banks, there is a pretty clear message: corporates require banks that can offer good lending/credit lines, are themselves recognised as a good-quality credit and that can provide broad geographical coverage. In among this, corporates are placing more value on tailored solutions, market intelligence and access to research, while other measures of banking services – for example, strategic advice and league-table positions – fall down the list of requirements. Given that the survey also indicates a shift away from treasurers trying to segment their banking group by capabilities, this suggests that corporate treasurers are moving towards a simpler approach for engaging with their banks, with the one-stop-shop being a favoured model.

LOOKING FORWARD At the close of 2010, treasurers felt that the global situation was improving and the threat of market volatility was receding. However, the euro area sovereign debt crisis has dominated headlines and sentiment since the last survey, and euro break-up contingency planning is now a reality for many corporates.

The immediate future of corporate risk management is not easy to forecast. The regulatory and reporting environments are rapidly shifting, which could oblige corporate treasurers to constantly update their risk management policies and strategies. From the 2012 survey emerge a number of new and important challenges facing corporate treasuries in the coming years:

- increased awareness of counterparty credit, encompassing credit line availability with banks and the creditworthiness of both banking and trading partners;
- a focus on emerging markets, with treasurers needing to increase their risk management understanding of them as the world continues to look to these critical markets for growth;
- ongoing improvements in treasury capabilities, with treasurers expected to have a real-time understanding of the risks facing their businesses and the real economic impact of those risks; and
- adapting to new regulations, with changes in the regulatory landscape for banks having a knock-on impact on corporate end-users which will need to be closely watched by treasurers.

The 2012 survey shows that a number of key trends in corporate risk management remain in place. The changes seen in the last few years point towards an evolution rather than revolution in corporate risk management. Treasurers have built, and will continue to build, on the lessons learned from the crisis, and are managing to implement their improved risk management strategies across an ever changing global economic environment.



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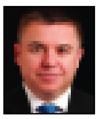

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