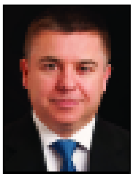
A landscape changed

THE FINANCIAL GROUND SHIFTED MASSIVELY DURING THE GLOBAL CRISIS, BRINGING HOME TO ORGANISATIONS THE NEED TO PAY A LOT MORE ATTENTION TO THEIR TREASURERS. BUT BOARDS STILL NEED TO BRING TREASURERS MORE CLOSELY INTO STRATEGIC DECISION-MAKING, AS THE 2010 BARCLAYS/ACT GLOBAL CORPORATE RISK MANAGEMENT SURVEY REVEALS.


Keith Gilmour


Sam Ford

The battlefield commissions won by corporate treasurers during the financial crisis are now being put to use to manage what is a very different landscape to the one that existed before 2008, according to an analysis of the results of the 2010 Barclays/ACT Global Corporate Risk Management Survey.

At the core of the survey of over 200 global corporate treasury teams is a clear sense that the elevation in the status of treasurers and the weatherproofing they gained during the crisis will be essential components for their companies going forward. In a world of increased underlying volatility, greater reliance on technology and the need for companies to make rapid decisions on growth strategies, the corporate treasurer occupies an increasingly pivotal role.

However, there still appears to be a gap between the risk management rhetoric espoused by corporate boards and the degree of freedom which corporate treasurers have to manage risks in their organisations effectively and efficiently.

Keith Gilmour, director, Barclays Capital Risk Solutions Group, says: "Even though, according to more than 70% of respondents, strategic risk management decisions are made above group treasurer level, there is still a feeling that senior management and boards need to be more informed and better engaged on these kinds of issues."

Consideration of the various components of the survey reveals some interesting insights into recent changes and shines some light on potential paths ahead.

RISK MANAGEMENT IN ORGANISATIONS Not surprisingly, the risk management issues keeping corporate treasurers awake at night are the usual suspects of foreign exchange (FX) transactional risk (two-thirds of respondents said this was a top-three issue), interest rate risk and liquidity/funding risk. More of a surprise is that liquidity/funding risks are expected to be less of a concern in the future.

While some treasurers may feel that these risks are receding, the financial markets themselves do not reflect this. Liquidity remains at a premium in many markets. These risks will only grow as treasurers focus more on other markets, echoed by the expectation that commodities and foreign earnings/net investment risks will be an increasing area of concern in the next three years.

"Emerging market exposures are also getting an increasing amount of airtime with our clients," says Sam Ford, managing director, Barclays Capital Risk Solutions Group, "both protecting the value of investments in low-cost countries and hedging against increased sourcing costs from them."

Two of the most striking results of the survey are that 90% of respondent companies have implemented or are about to implement some key changes to their risk management policy and that fully two-thirds of respondents now operate a centralised treasury model.

While the financial crisis was a catalyst for these changes, the key enabler has been technology investment, allowing treasurers to have more immediate insight into the various risks and positions being taken across the company. It seems clear that corporate treasurers have been extremely active in recent years, whether in restructuring treasury operations, monitoring and reporting risk to senior decision-makers or redefining risk management policies. But has this diverted attention from the actual business of managing risks?

Hedge accounting standards continue to occupy a place of priority – and to divide opinion. Some 63% of companies already apply hedge accounting on most of the solutions they use. But very few treasurers see it as truly useful in their risk management activity, with a number of comments from respondents indicating that hedge accounting is "a constraint that adds no value".

These results point to some of the key frustrations experienced by treasurers, who feel excluded from considering the full range of risk solutions for their business, either due to process overload or to the requirement to meet accounting rules. This begs the question of whether it is still the case of the tail wagging the risk management dog.

FOREIGN EXCHANGE RISK MANAGEMENT The FX markets continue to occupy a great deal of treasurers' time, not surprisingly considering that volatility in those markets has spiked dramatically and remains substantially above the average level of 2003 to 2008. That volatility has been felt equally by those who deal infrequently for small FX exposures and those who have multiple large exposures managed on a daily basis.

As with the FX markets, the trends in FX risk management are not clearly defined. While 74% of companies surveyed hedge their forecasted transaction risk, only 39% hedge net investment in foreign subsidiaries, and only one third of those actually hedge earnings translation. Other risks appear even lower on the priority list, with only 14% hedging contingent risk (e.g. tender offers, M&A deals) and only 2% hedging dividends. This is a surprisingly low number given the current focus on shareholder dividend payments.

There is a clear trend for increased hedging cover and an expectation that this trend will continue. Average hedging tenor is between a year and 18 months, as opposed to the tenors of less than one year immediately following the crisis. That said, only one third of companies are hedging beyond 18 months and only one quarter beyond two years. Where hedging cover has been reduced in the last three years, a mix of reasons are cited that all point towards increased business uncertainty, such as forecasting issues, unattractive markets or changes to policy. Few respondents (18%) cite issues with their banks as the reason for reducing cover (such as credit lines or counterparty risk).

There is also a lack of a clear trend in types of solutions used by corporates. The vast majority (91%) use simple cash FX products (spot, forwards and swaps) to manage their exposures, with 49% using some form of options-based solutions. The survey also shows that there is a fair balance of hedging approaches taken – from rolling to layered to static – but that less than 30% of respondents hedge based on market opportunities. Is this a matter of not having the right information/alerts to hand, or (more probably) being constrained by risk management policy and process? Again this highlights the changing landscape of risk management: while policies and hedging ratios are being revised and updated, the mix of solutions being considered is also changing.

Figure 1: Changing trends in risk management concerns

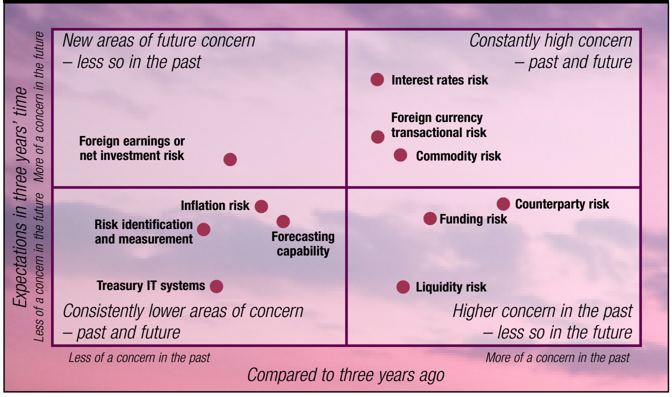
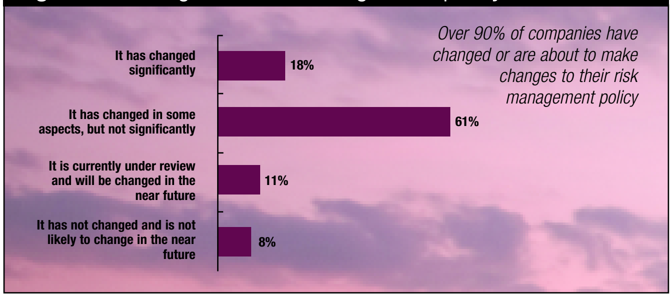


Figure 2: Changes to risk management policy



INTEREST RATES RISK MANAGEMENT Historical all-time lows in many interest rate markets have provided their own interesting challenges for treasurers. Half of those surveyed work for companies with debt levels of over $1bn, yet knowledge of interest rate hedging is generally lower than for FX hedging, possibly reflecting the fact that corporate finance issues are often dealt with outside the treasury function. However, it is clear that for many treasurers the management of interest rate risk (often the largest risk a company faces) is a top priority.

Of the companies that hedge interest rate risk, 45% have less than half of their debt in fixed rates and only 8% fully fix their liabilities. The majority of companies hedge to the same or shorter maturity than their debt, with 8% actually hedging a longer maturity, indicating there is some willingness to be flexible around the tenor of interest rate hedging.

Levels of interest rate hedging cover show a clearer trend than in FX. The last three years has seen 85% of companies increase or maintain their hedging levels, with 76% expecting the same trend in the coming three years. A much lower proportion have decreased or expect to decrease hedging cover, with survey respondents pointing to underlying market conditions, tightening credit lines and reduced certainty as the three top reasons, though none of these comes to the surface as the dominant factor.

A growing feature of interest rate markets is the use of a hedge co-ordinator. This approach can deliver an efficient execution approach for companies undertaking larger interest rate hedges that are split between a number of banks. A hedge co-ordinator has been employed by a quarter of companies surveyed, with most of those using one saying they would do so again.

Figure 3: Strategic risk management decisions

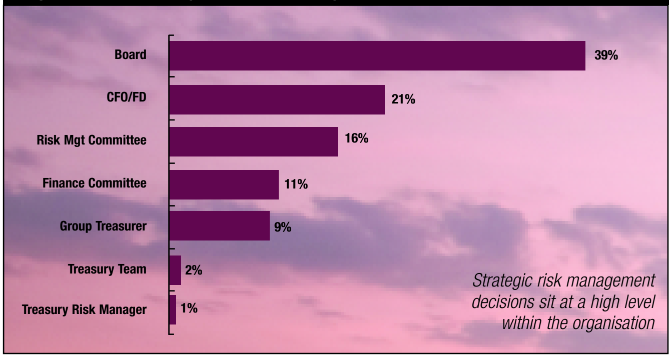


Figure 4: Core banking groups

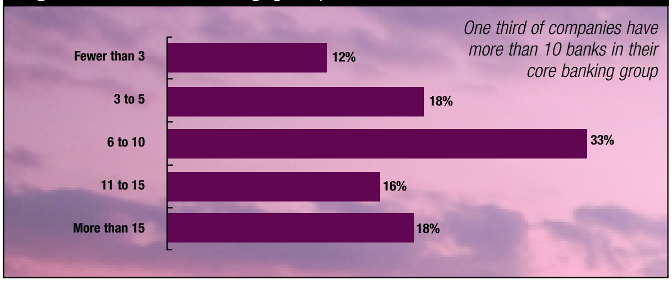
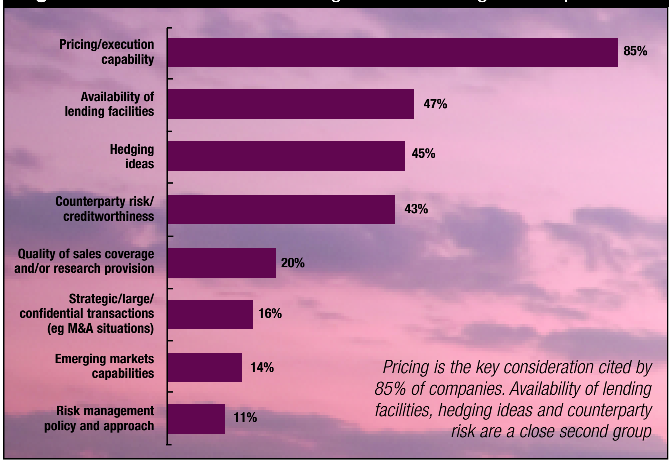


Figure 5: Priorities in choosing a risk management provider



CHANGING RELATIONSHIPS The way in which treasurers interact with banks will always be an overarching issue. What was once a one-sided pricing and execution relationship has become a two-way dialogue in which relevant information flow is all-important. The survey shows that while pricing remains the key factor in choosing risk management providers (cited by 85% of respondents), hedging ideas provided by banks is seen as third most important – availability of lending facilities ranks only marginally higher. Also, bank groups are not shrinking: 67% of companies have more than five banks in their core banking group and 74% of companies approach all their core banks for their regular hedging needs. There is a clear message here for banks: in order to be the risk management partner of choice, banks need to distinguish themselves through more than just price. Corporate treasurers value ideas and quality of coverage.

A more puzzling observation for the banks is that virtually all respondents felt that the risk management tools and solutions offered by banks have kept pace with the requirements of treasurers. This suggests that treasurers are generally happy with the range of solutions being offered, although it may be a case of there being "unknown unknowns", with treasurers unaware of what is available. As there is an increased reliance on technology for everyday transactions, the nature of the treasurer-bank relationship is bound to change. The focus will increasingly be on the extra value that a bank can bring to the relationship.

WHAT LIES AHEAD Overall, the survey illustrates the rapidly changing priorities in risk management. Given the increased number of discussions corporate treasurers are having around policy, best practice and peer group understanding, it is apparent that the more successful treasurers are those who are more informed and therefore better able to make decisions. We see a number of important challenges facing corporate treasuries in the next three years:

- multiplication of risks, with treasurers required to identify, monitor and manage a wider variety of risks;
- treasury as a value generator, with treasurers shifting towards a more active risk management approach and generating shareholder value;
- pack leadership, with the more sophisticated treasurers and treasury teams standing out and defining best practice both within and across industry sectors; and
- evolution of banking relationships, with banks striving to become trusted partners of the treasurer across all risk management activity.

While the perfect storm in the financial markets has abated, it is clear that there are still significant global risks that can seemingly arrive out of nowhere like a rogue wave, such as concerns over sovereign debt of certain European countries or conflicting signs over whether the global recovery is actually a recovery at all. Against this economic background, risk management must remain near the top of the agenda for corporate boards and treasurers alike.

The survey suggests that a continued focus on risk management by corporate boards is not guaranteed. As treasurers continue to improve visibility and control over the risks in their businesses, there could be a reversion to pre-crisis attitudes, with risk management considered to be a necessary cost of doing business. Corporate treasurers are the backstop against the widening of the risk management gap, provided their hard-fought commissions on the financial battlefield can be upheld.

Barclays would be pleased to discuss the survey further with treasurers. For details, or for any other questions on our Risk Solutions Group, please contact:

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