Real world mechanics

TREASURERS SHARED EXPERIENCES AND SUGGESTIONS FOR TACKLING THE KEY ISSUES OF FUNDING, REGULATION AND GROWTH AT THE MOST RECENT TALKING TREASURY EVENT, HELD IN LONDON. **PETER MATZA** LISTENED TO A VIGOROUS DEBATE.

Colin Tyler, the ACT's chief executive, opened the day by asking how treasurers can help the real economy to get moving again. The real economy needs to take risks to make a profit, and to take those risks treasurers and their colleagues need risk management competence and training – or must pass the risks on to those who can manage them. The ***talkingtreasury*** programme is designed to help treasurers discuss these and other issues. We are grateful to JP Morgan Asset Management for its continued support of the ACT and ***talkingtreasury***, which attracted nearly 100 treasurers to its most recent meeting, in February.

CORPORATE FUNDING STRATEGY IN A NEW FINANCIAL LANDSCAPE The first panel of the event, on corporate funding strategy, presented its credentials in the funding markets to offer context to the debate. For example, Bunzl group treasurer Tim Hayter talked about his funding strategy and preference for the US private placement (PP) market. However, he tends to use independent bilateral facilities with a core group of banks, diversified by maturities, needs, geography and so on.

Kwok Liu, senior capital markets manager at National Grid, outlined the business's £23.6bn borrowings, including having £5.6bn RPI-linked (the second largest bond in the UK after Network Rail's) and most recently issuing the largest (£282.5m) retail bond on ORB.

David Peters, treasurer of Grosvenor, talked about property investing (£12bn assets) and funding (via £4.3bn debt) using a clear debt/asset maturity strategy and a diversified approach with revolving credit facilities (RCFs), new US private placements and secured project financings. Jane Pilcher, group treasurer of Anglian Water, briefly outlined a long-term debt management programme for a regulated utility.

The panel discussed the merits or otherwise of bilateral facilities versus revolving credit facilities. There were some concerns with euro zone banks withdrawing from lending, even from secured facilities, and general agreement about many European banks having US dollar funding difficulties.

More broadly, the general tone of the panel's discussion was that treasurers need to consider the markets in much greater detail and across different investor classes than was previously the case. Facilities, geographies, documentation, pricing and credit are now equally important individual factors to be taken in account. However, there is still a need to keep relationships – whether with banks or investors – close so that both sides feel comfortable and valued. This may be particularly important if a business is changing in size or focus for example, especially if there are documentation issues or cross-border relationships.

The panel agreed that cross-currency swap availability (let alone pricing) was a challenge in terms of banks understanding pricing and credit provision. It is not obvious which banks remain constant in the swap markets. This may be true even for businesses that use collateral agreements. Either way, treasurers should be aware that the days of cheap and easy currency funding are over.

In response to the interactive voting session, a question was raised whether the traditional bank/treasurer relationship was stable. The treasurers on the panel felt that flexibility across debt and ancillary business pricing would serve a treasurer well but that companies needed to maintain competition to "keep their banks honest".

Treasurers might also be well served by doing the math on what banks are charging against what banks are earning, and challenge the pricing if they feel returns and pricing are out of step. One delegate rather pointedly suggested that demonstrating what the bank relationship costs might help dissuade the board from giving lucrative corporate finance business to third parties – or at least appreciate the treasurer's frustration when that happened.

PREPARING FOR NEW REGULATION Unusually for the ***talkingtreasury*** format, the second panel consisted mainly of market professionals rather than treasurers, which indicates the complexity and uncertainty for treasurers about political and legal regulation. John Grout, the ACT's policy and technical director, offered a gloomy assessment of the current wave of regulation. He suggested the best that real economy end-users would be able to do was influence regulators to make standards "unacceptable" rather than "impossible".

Stephen Powell, a partner at law firm Slaughter and May, gave an overview of the current regulatory environment for banks, treasury and the real economy. Banks will be forced to raise more (perhaps more costly) capital, they will have more capital constraints on credit and even be subject to enforced legal controls on activity (eg. UK Vickers) and so on. Treasurers will need to worry more about bank survival, regulatory pricing and political interference (the law of unintended consequences) as well as access to hedging tools and techniques. The prognosis is bleak and much uncertainty remains.

Paul Watters, head of corporate research at Standard & Poor's, talked about the ratings perspective but not about regulation of the ratings market itself. Unfortunately, his message was that "it's mostly bad news". One modest benefit of recession and the Western financial crisis has been that the absolute cost of corporate funding remains relatively low. Against this, however, Watters suggested that S&P has noted that domestic regulators across Europe are trying to ensure banks are making high-teens levels of returns, which is likely to constrain credit availability, raise pricing or both. S&P thinks that the sub-investment grade loan market is likely to see more dislocation and that treasurers of lower credit quality companies may have to work much harder to secure funding for areas such as M&A and longer-term capital projects.

Jiro Okochi, CEO of Reval, gave an overview of the US timeline and the drive to transparency, managing collateral positions and other aspects of US regulatory change. The good news here is that non-financial corporates may escape much of the new regime provided their transactions are commercial-based activity. Having said that, his view was that the regulators seem intent on forcing collateral management by any means. His advice was to the point: treasurers need to be up to date and talking actively with their banks and their professional associations.

In asking what the impact of regulation would be on long-term corporate funding strategy, one delegate wondered whether options were an answer. The panel's view was that options might offer some extra value and flexibility and clearer pricing but the treasurer also takes on more counterparty risk and complex accounting issues. In practice, although options may offer the best market alterative, treasurers will need to look at more currency matching of assets and liabilities (in the widest sense), risk transfer (to suppliers or customers) or even going back to equity investors via various hybrid types of funding.

The panellists

PANEL 1: CORPORATE FUNDING
- **Charles Barlow**, group treasurer, Coats (chair)
- **Tim Hayter**, group treasurer, Bunzl
- **Kwok Liu**, senior capital markets manager, National Grid
- **David Peters**, treasurer, Grosvenor Group
- **Jane Pilcher**, group treasurer, Anglian Water

PANEL 2: NEW REGULATION
- **John Grout**, policy and technical director, ACT (chair)
- **Jiro Okochi**, CEO and co-founder, Reval
- **Stephen Powell**, partner, Slaughter and May
- **Paul Watters**, head of corporate research, corporate ratings, Standard & Poor's

PANEL 3: BUSINESS GROWTH
- **Bruce Bettencourt**, managing director, JP Morgan (chair)
- **Greg Croydon**, group treasurer, IMI
- **Paul Phillips**, group treasurer, easyJet
- **Jonathan Slade**, global head of corporate finance, Rio Tinto

The panel closed on an upbeat note of seeing some evidence that regulators – if not their political masters – were beginning to recognise the impacts of regulation on the real economy.

STRATEGIC PLANNING FOR BUSINESS GROWTH Bruce Bettencourt, managing director of JP Morgan, gave a short but revealing overview of where the banking industry finds itself. Financial market volatility has been high for two to three years, there is considerable diversity in global economic patterns, and the banking industry is struggling with regulation. JP Morgan is seeing large corporates piling up cash, constraining their capex, looking to embed in growth markets or regions, and asking for a wider range of banking services especially in non-credit funding options (eg. invoice management). Providing solutions rather than selling product is clearly a test of a bank's commitment to a customer.

The panel's view was that it might just be luck according to what type of business you are, what industry sector you are in and where you operate geographically. The treasury's financial and operational input to corporate strategy is critical because of the volatility in the Western financial system and the lack of maturity in developing financial markets. This means the decision about interest rate management is no longer a detail play but has huge implications for investment decisions, investor relations and corporate growth.

It might seem a throwaway comment but one treasurer declared: "Cash has become the ultimate committed facility for treasurers worried about the future." Of course, this prompts the question about what the true cost of carry is. Is cash in hand safe in a fractured banking system or is there value in repaying debt? Or is the latter "wasted" cash? Are there non-cash issues (eg. reducing cash reduces counterparty risk) that need to be weighed?

For investment-grade credit quality business with lowish leverage the issue for the treasurer looking at funding becomes one of balance – how much do I need? what facilities? which relationships? – against corporate financial strategy and potential change. For those looking for funding, there was an interesting suggestion that some PP investors could provide M&A "insider" prefunding to avoid using banks; does that suggest an increasing move for the UK/European financing model, changing to a US bond market finance structure?

In response to a question on counterparty risk, the audience revealed that most of them used up to five different metrics when looking at bank exposures. When measuring deal exposure, most use mark to market (priced via a market feed to their treasury management system) and some form of view of their future exposure. More than two-thirds said they didn't currently have a collateral agreement with their banks.

The consensus view on the euro zone crisis was that treasurers need to look across their whole business to see what contingency planning they could or should do – outside of the obvious immediate financial impacts – and ensure that they look up and down the supply chain.

The ***talkingtreasury*** half-day closed with a keynote speech from well-known commentator and technologist Chris Skinner, a popular speaker from previous ACT events. Skinner considered the question of whether the bank-corporate relationship was broken.

Uncertainty is the prevailing emotion in banking and financial services generally. However, a quick question to the delegates revealed that 50% thought the overall position hadn't changed since the onset of the financial crisis. Skinner then wondered if the crisis had been helped or hindered by technology. Unsurprisingly there was no firm conclusion here other than that if there is bad news we now get to learn it sooner.

To some extent the future matters more even if the past and present are uncertain. Real-time risk management and assessment are at best patchy in the financial services industry. This hardly builds confidence in the future of financial services. Skinner also suggested that social media would change the dynamic of financial relationships, certainly for retail banking and possibly for business banking provided that web security could be controlled.

Skinner asked a last question about the bank-corporate relationship; a disgruntled 84% of the audience thought the banks cared more about their own business than that of their customers.

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What treasurers really think

ACT CEO Colin Tyler hosted an interactive voting session addressing today's treasury concerns using similar results from 2011 as a backdrop. The ACT uses these surveys to guide its relationships with regulators, governments and others in the stakeholder community.

Representation at the event showed a bias towards lean treasury teams, although in some cases treasury is supported by other finance functions in companies (see graphs below, top left).

There was an overwhelming and increased preference for banking sector stability, with treasurers tired of sector volatility (top right). On the question of the size of banks, the response was mixed but big was less important (bottom left).

An interesting feature of the renewed volatility in global economies in 2011 was the resounding "no" given to the question of whether boards have increased their risk appetite in the past 12 months (bottom right). Last year's answer reflected the relative stability of 2010.