AN ACT STUDY INTO HOW BUSINESSES ARE RIDING THE STORMY SEAS OF RECESSION OFFERS SOME BRIGHT INTERLUDES. **MARTIN O'DONOVAN** REPORTS.

Charting a course

The ACT has reported on the impact of changed banking and market conditions on the treasury activities of large UK corporates following a series of in-depth interviews with members in FTSE 350 companies. Amid the generally gloomy views there was some good news and a few surprises.

Well-prepared treasury teams took advantage of the benign markets in 2007 and, if anything, overfunded. Even after the start of the credit crisis it paid to take advantage of any funding windows that appeared. More often than not it does not pay to wait for times to get better, it seems.

Executive summary

- ACT research into how corporates are tackling the downturn offers positive points and helpful tips despite a realistically muted outlook. Relationships are key at a time when even the most careful husbanding of resources can be scuppered by third parties, but a basic checklist of considerations will help treasurers to steady the ship.

COST OF CREDIT Unsurprisingly, all new borrowers have seen their borrowing margins soar. While the surge started in July 2007, with a slight abatement in autumn 2007, most of the increase has occurred since the collapse of Lehman Brothers last September. None of the survey respondents thought borrowing margins and conditions would return to their long-run averages during 2009; most thought it would be at least 2011 before we see much improvement.

As a rule of thumb, members' borrowing margins have risen to three and five times their company's pre-crisis levels. Commitment and arrangement fees have risen along with borrowing margins.

FUNDING The good news is that bank loans and refinancing are happening, but conditions are trickier and the amounts available are being reined back, often to nearer 60% of the size of old facilities. There are many reports of corporates losing banks with which they have traditionally had relationships due to a combination of:

- mergers between banks;
- banks shrinking their balance sheets;
- banks focusing more on profitable ancillary business;
- banks retreating to the home markets they know best out of

prudence and need for support from their home authorities; and
- banks being reluctant to lend because of higher perceived risk in certain industry sectors such as retail, automotive and building.

While some banks are, as it were, taking their ball home, foreign banks are still lending to central treasuries or even holding companies if they can demonstrate ancillary business for the bank in its home territory. "If you tick all the right boxes, then they will lend," said one treasurer. Relationships are important in maintaining bank facilities and this is expected to continue.

Most corporates in the survey are adequately funded for the immediate future, although a small number have work to do during 2009. This is partly due to our sample omitting distressed companies. None of the companies surveyed had maturities before 2010; for 70% the earliest maturities were 2011 or later. However, we were surprised to hear that a few were prepared to wait until nearer to facility maturity before starting serious negotiations with banks. A modest number have already renegotiated facilities using forward starting dates to ensure banks' commitments are maintained in sufficient volume and this is set to become common.

Banks have also cut uncommitted lines, which have traditionally used by a small number of borrowers for managing working capital, although this is by no means across the board. Uncommitted lines for straightforward lending remain available, but in lower amounts. Lines being actively used for letters of credit and bonding remain by and large unaffected. Of the companies interviewed, 81% had experienced no change or only a marginal reduction in uncommitted lines. Some comments were received about re-introducing a scheme akin to the old acceptance credit markets to help corporates and their banks to finance trade-related working capital – something the ACT has been keen to promote.

CREDIT INSURANCE For some businesses, availability to suppliers of credit insurance seems necessary for the firm to receive credit. There were some reports of the effects of withdrawal of credit insurance being felt, although in many cases the credit was continued. The difficulties with credit insurance is that those companies whose suppliers take out insurance on them have very little contact with the insurers. There are few opportunities to understand the attitudes of the insurers or even to be aware of the extent of their cover. Companies can find their cover removed with no notice and without any chance to influence events.

WORKING CAPITAL Some corporates are putting more effort internally into managing their working capital. However, not all corporates are focusing on this yet, admitting that greater attention will be applied as 2009 unfolds. For some treasurers quick wins have been achieved by centralising pockets of cash in subsidiaries putting reducing borrowings to use. Experience of customers paying later is muted, although in some industries companies are looking at the financial benefits or better business relationships that come from not squeezing suppliers and customers – indeed, offering them finance. No deterioration in customer payments had been experienced by 78% of the companies surveyed.

COUNTERPARTY RISKS The credit risk from exposures to financial counterparties has assumed a higher profile than usual. Nearly all corporates said their criteria for permitting dealing with a counterparty remained unchanged and usually started with credit ratings, layering on other criteria. What has changed is a greater

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emphasis by most companies on spreading the risk across more parties so that monetary limits on given names have been reduced. Limits such as "no more than 10% with any one party" have been introduced by some. A number of corporates are also watching prices of credit derivatives that cover their bank counterparties. Where these have widened appreciably, actions to mitigate risk have been taken even if the rating of the bank has not altered.

A few companies take the opposite approach and concentrate their limits on banks deemed too big to fail, or prefer their credit exposures to be with relationship banks from which they are borrowing at the same time. This strategy may provide some comfort but is unlikely to include a rigorous right of offset should the bank become insolvent.

MONEY MARKET FUNDS The desire to diversify and spread credit risk persuaded some companies to invest in AAAm money market funds. However, attitudes were very mixed. Some had stopped using money market funds because of lack of transparency on the underlying investments. Others had undertaken initial and continuing due diligence on the funds' investments, were selective about the funds used, looked for a powerful fund sponsor and limited their investment to a small proportion of total fund size.

INCONSISTENT MESSAGES With increased volatility in credit markets, banks' credit committees and capital allocation committees are becoming disconnected from relationship officers. It is therefore harder for borrowers to know whether their deal will be approved by a bank even though their relationship officer may assert it will be. Some respondents said that banks gave the impression of not knowing their own minds from day to day.

There is a desire for banks to provide more clarity and certainty about their appetite for new business. It is frustrating to explore and negotiate deals with the assurance that the bank is able to do it, only for a change in overall bank policy to make it unavailable, or available only under markedly changed conditions. "Banks are wrestling with what their own rules are," said one treasurer. Another added: "Bankers don't know what they can deliver at the moment."

Banks are negotiating tighter documentation for loans but, worryingly for borrowers, are using requests for minor or technical changes to documents to renegotiate deals (pricing, maturity, terms, amount). In new lending agreements, a minimum drawdown period of three months is becoming the market norm, presumably prompted by lenders' worries that liquidity in other periods might not be so good, or in an attempt to reduce administrative costs.

DERIVATIVES In the foreign exchange markets there has been very little disruption to the spot markets. Forward deals and swaps, however, have been and still are subject to difficulties – disparate pricing between different banks, lack of willingness to take on the positions and delays in dealing driven often by the need for additional credit headroom.

Credit exposure on interest rate swaps has become an issue for both sides. Some banks are terminating their exposures (despite informal undertakings to the contrary in better times) by exercising break clauses or where credit support agreements exist are calling for cash collateral. Equally, some corporates with large in the money exposures to banks are seeking collateral.

EXPECTATIONS FOR THE FUTURE Corporates were generally sanguine about their access to sufficient funding for the next year on account of pre-existing facilities, but some were concerned about refinancing risk beyond this should conditions in the banking markets not improve. For this reason some borrowers are planning to start their refinancing negotiations in good time and also to develop access to alternative non-banking sources. This must be the wise and prudent course of action, not least to ensure the company can meet the going concern requirements for reporting.

Most accepted that for many years to come the size of the banking market would be significantly reduced. However, it was expected that the capital markets would re-open for the larger companies which used those markets in the past. Some respondents went further, believing that capital markets might develop to become more widely accessible by more corporates with disintermediation of the banks a possibility. Private placement markets are likely to be important for smaller companies, with the caveat that documentation can be tricky, and even more so should amendments or waivers be required.

The need for a credit rating to access alternative investors is widely recognised and many unrated companies are considering seeking their first rating.

RECOMMENDATIONS FOR CORPORATES It is very clear that the financial markets have changed significantly in the last 18-24 months and will remain uncertain and changeable in the near term. This survey has highlighted a number of areas that members of the ACT should consider:

- Rollover and renegotiate bank loans as soon as possible (fund early and fund long).
- Review capital structure and alignment with the group's (revised) strategy and market conditions.
- Corporates that could in principle access the public capital markets but do not have a rating should consider obtaining one to facilitate more diverse funding and to avoid reliance on the bank markets.
- Consider setting up commercial paper programmes.
- Shop around for prices for forwards, commodities and swaps.
- Think carefully about whether the company's counterparty policy is still appropriate given increasing volatility and lower ratings for banks, but allow for those that are supported by governments.
- Consider the pros and cons of credit support agreements with swap counterparties.
- Consider set-off arrangements very carefully across the board for dealings with a bank to reduce exposure to its credit.
- Check bank documents very carefully to ensure compliance as waivers could be difficult or expensive to obtain.
- Ascertain how much is spent with banks across the corporation and help the relationship officer understand the full revenue flow received.
- Investigate the company's pension fund and the impact caused by dislocations in interest rate markets and inflation markets as well as widening borrowing margins and falling equity prices.
- Ensure that banks are not allocating credit for facilities that are no longer needed, or that central treasury is unaware of.
- Last, and most important, communicate financing plans as appropriate to the company's board, its credit rating agencies, its banks, and to its capital market investors.

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The full ACT report (Credit Crisis and Corporates: Funding and beyond) is available at:
www.treasurers.org/creditcrisisimpact